Supreme Court, U.S.
FILED
MAR 13 1980
MICHAEL RODAK, JR., CLERK

IN THE

# SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79-1423

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

*Appellee.*

**On Appeal from the Court of Appeal, Second Appellate District, State of California.**

## JURISDICTIONAL STATEMENT

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IN THE

# SUPREME COURT OF THE UNITED STATES

October Term, 1979

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No. ————

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

*Appellee.*

---

**On Appeal from the Court of Appeal, Second Appellate District, State of California.**

---

## JURISDICTIONAL STATEMENT

---

Appellant, The Western and Southern Life Insurance Company, appeals from the judgment of the Court of Appeal, Second Appellate District, State of California, reversing the decision of the Superior Court of Los Angeles County. Appellant's petition for hearing by the Supreme Court of California was denied December 27, 1979. Appellant hereby files the jurisdictional statement as required by Rule 13, paragraph 2, of the Rules of the Supreme Court of the United States.

## OPINIONS BELOW

The minute order of the Superior Court's Intended Decision and Memorandum of Intended Decision, the Court's Conclusions of Law and its Judgment are set out in Appendix A, beginning at page 1a. The opinion of the Court of Appeal and the order of the Court of Appeal modifying its opinion and denying Appellant's Petition for Rehearing are set out in Appendix A, beginning at page 27a. The order of the Supreme Court of California is set out in Appendix A, page 36a. The original Court of Appeal opinion before its modification in response to Appellant's Petition for Rehearing appears at 159 Cal. Rptr. 539 (1979). The decision of the Supreme Court of California denying a hearing ("Hearing Denied") remains unpublished.

## GROUNDS FOR JURISDICTION

This is an appeal from a judgment of the Court of Appeal, Second Appellate District, State of California, entered November 2, 1979. Petition for Rehearing by the Court of Appeal was filed by Appellant on November 19, 1979. In an order filed November 28, 1979, the Court of Appeal modified its opinion of November 2, 1979 and denied rehearing. On December 11, 1979, Appellant filed a petition for hearing of this cause by the Supreme Court of California, which denied the petition on December 27, 1979. Notice of Appeal to this Court was filed with the Court of Appeal, Second Appellate District, State of California, on February 11, 1980, a copy of which, duly stamped by such Court as filed on such date, is set out in Appendix B, beginning at page 37a. Notice of Appeal to this Court was also sent to the Supreme Court of California on February 5, 1980 and was returned by the Clerk of such Court with the advice that the record in this case

was in the possession of the Court of Appeal. A copy of such letter is set out in Appendix B, page 40a.

Appellant, an Ohio insurance company, asserts that the following described discriminatory actions of Appellee in fixing the tax liability of Appellant, a foreign insurance company, violate the Constitution of the United States.

1. The levying of retaliatory taxes upon Appellant for the years 1965 through 1971, under California Constitution, Article XIII, section 14-4/5 (f) (3), as amended November 3, 1964, (California Constitution, West Supp. 1964), California Insurance Code, section 685 (West 1972) and California Revenue and Taxation Code, section 12284 (West 1970); and

2. The denial of a credit against premium taxes for 1966 through 1971, under California Constitution, Article XIII, section 14-4/5 (e), (West Supp. 1966), California Revenue and Taxation Code, section 12241 (West 1970).

These constitutional and statutory provisions are lengthy, and the pertinent texts are set out in Appendix C, beginning at page 41a. Appellant paid the taxes under protest each year and made claims for refund thereof on the grounds of violation of the federal Constitution.[1] Appellee denied the claims, and Appellant brought suit for refund in the Superior Court of Los Angeles County under authority of California Revenue and Taxation Code, section 13103. (Appendix C, p. 46a).

Appellant alleged in its complaint and the trial court found that the California taxes unconstitutionally affected

[1] These claims were timely filed with Appellee, as required by California Revenue and Taxation Code, section 13102. See Appendix C, page 45a.

interstate commerce and discriminated against Appellant contrary to the guarantees of the Fourteenth Amendment to the United States Constitution. The Court of Appeal reversed the lower court, expressly holding that the California legislation did not violate the cited provisions of the United States Constitution. The Supreme Court of California denied Appellant's Petition for Hearing, and the Court of Appeal decision became final on December 27, 1979. Thus, the statutory provision conferring jurisdiction of this appeal upon this Court is 28 U.S.C. § 1257 (2).

Cases sustaining the jurisdiction of the Supreme Court herein are *WHYY, Inc.* v. *Glassboro,* 393 U.S. 117 (1968); *Reserve Life Insurance Company* v. *Bowers,* 380 U.S. 959 (1965); and *Wheeling Steel Corporation* v. *Glander,* 337 U.S. 562 (1949).

In the *Glassboro* case, this Court considered an appeal from a decision by the Supreme Court of New Jersey denying the appellant's claim that denial of an exemption from state property taxes because of its out-of-state incorporation denied it equal protection of the laws in violation of the Fourteenth Amendment. In the *Reserve Life Insurance* case, this Court considered an appeal from a decision by the Supreme Court of Ohio dismissing an appeal from a Court of Appeals decision which had held that an Ohio statute taxing foreign insurance companies doing business in Ohio on their personal property used in business while exempting domestic companies did not violate the Fourteenth Amendment. In the *Wheeling Steel* case, this Court considered appeals by foreign corporations from judgments by the Supreme Court of Ohio affirming assessments of ad valorem taxes on out-of-state receivables against a claim of Fourteenth Amendment violation. In all three cases, the decisions appealed from were reversed by this Court, and the state statutes held unconstitutional.

## QUESTIONS PRESENTED

The questions presented by this appeal are:

1. Does a state statute which levies a tax on foreign insurance companies but not on domestic insurance companies impose an unconstitutionally discriminatory burden on interstate commerce or deny to foreign insurance companies due process of law and equal protection as guaranteed by the Fourteenth Amendment to the United States Constitution?

2. Does a state statute which grants domestic insurance companies a tax credit while denying such a credit to foreign insurance companies impose an unconstitutionally discriminatory burden on interstate commerce or deny to foreign insurance companies due process of law and equal protection as guaranteed by the Fourteenth Amendment to the United States Constitution?

From 1965 to 1971, the State Board of Equalization of the State of California assessed against Appellant "retaliatory taxes" under the authority of the California Constitution, the Insurance Code, and the Revenue and Taxation Code. This legislation imposes an additional tax on a foreign insurance company doing business in California when the state of incorporation of the foreign insurer imposes on California insurance companies doing business in the foreign state higher taxes than California imposes on insurance companies from that foreign state doing business in California. By definition, this tax is *never* imposed on an insurance company incorporated in California, and its imposition is not dependent upon unequal treatment of foreign and domestic insurers by the foreign state. Were it so dependent, the tax would be called an "anti-discrimination retaliatory tax" (Appendix A, p. 7a) because its objective would be to discourage other states from discriminating against California insurance companies

by taxing them at rates higher than their own domestic insurers.

The parties herein stipulated, however, that Ohio did not impose a higher tax burden on California (or other foreign) insurers than on its domestic insurers,[2] and the trial court so found.[3] Ohio taxes all insurance companies equally, but the tax burden on insurance companies, both domestic and foreign, is higher in Ohio than in California. Therefore, an Ohio insurance company doing business in California pays an additional penalty tax to the State of California. Since this tax is based on a comparison of a foreign state's tax burdens with California's tax burdens, it is known as a "comparative retaliatory tax." Appellant brings before this Court the question of its constitutionality.

To exacerbate Appellant's tax predicament, Appellant also was denied full credit against its premium taxes for real property taxes paid with respect to its principal office in California for 1966 and later years under authority of the California Constitution and the Revenue and Taxation Code. This legislation grants *only* to California insurance companies a credit against insurance premium taxes for the full amount of real property taxes levied on their principal offices in California. The credit for foreign insurance companies is limited to the proportion of such real property taxes equal to the portion of the principal office property occupied by the foreign insurance company. Appellant challenges as unconstitutional the granting of a greater

---

[2] ¶ 2 of the Stipulation of Facts filed in the lower court states:
. . . by the laws of the State of Ohio, taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations or prohibitions imposed upon life insurers of California analogous to plaintiff doing business in Ohio, or upon their agents therein, were not in excess of those imposed by the State of Ohio upon such insurers of Ohio or upon their agents therein.

[3] ¶ 7, Conclusions of Law, Appendix A, p. 21a.

credit to a domestic insurer than a similarly situated foreign insurer.

As a result of these two aspects of California's taxation of foreign insurance companies, Appellant was forced to pay $977,853.57 more in taxes for the years here in issue than a California insurer of the same size and asset mix and doing equivalent business would have paid.

## STATEMENT OF THE CASE

Appellant commenced this action on May 17, 1971 by filing a complaint in the Superior Court of the State of California for the County of Los Angeles, seeking refund of retaliatory taxes paid under protest for the years 1965 through 1969, inclusive, and premium taxes paid under protest for the years 1966 through 1969, inclusive, claims for credit and refund of which previously had been denied by Appellee. Each claim was incorporated by reference in the complaint and was attached thereto, and an averment was made that each statement in the claim was true. Each claim concerning refund of retaliatory taxes alleged, *inter alia,* that the tax was erroneously and illegally computed, assessed and collected, and illegal in its entirety and specifically that its imposition violated the equal protection and due process provisions of Section I of the Fourteenth Amendment to the Constitution and the commerce clause of Article I, Section 8 of the Constitution. Each claim concerning refund of premium taxes alleged, *inter alia,* that the denial of the principal office deduction similarly violated the equal protection and due process provisions of Section I of the Fourteenth Amendment and the commerce clause of Article I, Section 8 of the Constitution. In its answer, filed June 4, 1971, Appellee acknowledged that the copies of the claims for refunds of taxes paid incorporated in Appellant's complaint were true copies of

such claims, but denied that Appellant was entitled to refunds.

By stipulation of the parties filed December 31, 1976, Appellant's complaint was amended to include a prayer for refund of taxes paid for the years 1970 and 1971, subsequent to the filing of the original complaint, and Appellee's answer was extended to cover such amended complaint. Also on December 31, 1976, the parties filed a Stipulation of Facts which was admitted into evidence by order of the trial court on June 10, 1977.

The Superior Court for the County of Los Angeles, trying the case without a jury on the Stipulation of Facts, and following oral argument of counsel addressed principally to the federal constitutional questions, found both the retaliatory tax and the denial of the principal office deduction violated Appellant's rights under the United States Constitution. The Superior Court said (Memorandum of Intended Decision, Appendix A):

> This California tax is plainly discriminatory against interstate commerce. . . . It provides a direct commercial advantage to domestic business at the expense of out-of-state business. (p. 11a).
>
> . . . It is also self evident that by the McCarran-Ferguson Act Congress could not effectively consent to state taxation which violates the due process clause of the United States Constitution. (p. 13a).
>
> . . . We find that the retaliatory tax herein is discriminatory in fact and violates both the due process and commerce clauses of the United States Constitution. (p. 16a).
>
> Thirty years ago in *Freeman* v. *Hewit* (1946) 329 U.S. 249 at 252 the United States Supreme Court said, with reference to the many opinions that are pertinent to this subject, "To attempt to harmonize all that has been said in the past would neither clarify what has gone before nor guide the future." This court is

> encouraged by the readiness with which the United States Supreme Court has recently overturned some of the historically unsound and illogical precedents in the field of state taxation. Just this year *Spector Motor Service* v. *O'Connor,* (1951) 340 U.S. 602 was specifically and unanimously overruled by *Complete Auto Transit, Inc.* v. *Brady,* [430 U.S. 274 (1977)]. Just last year, in *Michelin* v. *Wages* (1976) 423 U.S. 276 the court unanimously overruled *Low* v. *Austin* (1872) 80 U.S. (13 Wall.) 29. Thus encouraged, and with the original purposes of the due process, equal protection and commerce clauses in mind, and following the more recent reasoning and analysis of these matters by our highest court, this court concludes that the denial by defendant to plaintiff of the principal office deduction is an unconstitutional discrimination, that the California constitutional provision and statute mandating such denial violates the United States Constitution and that, therefore, plaintiff is entitled to that credit for all tax years pertinent herein. (p. 17a).

In its conclusions of law (Appendix A, pp. 19a-24a), the trial court held:

> 2. The authority to regulate and tax the insurance industry given to the states by the McCarran-Ferguson Insurance Regulation Act, 59 Stat. 33, 15 U.S.C. §§ 1011-15, could not and did not eliminate the restraints on state action in the Constitution of the United States.
>
> . . .
>
> 8. Section 685 of the California Insurance Code and Article XIII Section 14-4/5 (f) (3) of the California Constitution impose a comparative retaliatory tax which neither prevents discrimination by other states nor insures even-handed treatment by those states of California insurers.
>
> 9. The California retaliatory tax as effective for the years 1965 and following discriminates against in-

surers from other states, including Ohio, thereby providing a direct commercial advantage to local business and discriminated against interstate commerce, and, therefore, violates both the due process and commerce clauses of the United States Constitution.

. . .

16. Discrimination in granting a credit for real estate taxes against the gross premiums tax is prohibited by the due process and equal protection clauses of the Fourteenth Amendment to, and by the commerce clause of Article I, Section 8, Clause 3, of the United States Constitution.

This decision was appealed to the Court of Appeal by the State Board of Equalization on December 21, 1977. In its November 2, 1979 decision the Court of Appeal stated (Appendix A, p. 28a):

> This case involves the constitutionality of two provisions of California law imposing taxes on foreign insurance companies. The trial court found in favor of the plaintiff insurance company, holding that one of these provisions (the so-called retaliatory tax) was unconstitutional.

The Court of Appeal then stated (Appendix A, p. 31a):

> For many years, under the compulsion of *Paul* v. *Virginia* (1868) 75 U.S. (8 Wall.) 168, which had held that the business of insurance was not "commerce" within the meaning of the Commerce Clause of the federal Constitution, the states had imposed a variety of retaliatory taxes. In 1944, in *United States* v. *South-Eastern Underwriters Assn.* (1944) 322 U.S. 533, the Supreme Court overruled *Paul* v. *Virginia* and held that the business of insurance was within the commerce clause. Shortly thereafter, Congress enacted the so-called McCarran Act (59 Stats. 33, 15 U.S.C. §§ 1011-1015). That statute provided that

"the business of insurance . . . shall be subject to the law of the several States which relate to the regulation or taxation of such business." In *Prudential Ins. Co.* v. *Benjamin* (1946) 328 U.S. 408, the Supreme Court construed that statute and concluded that Congress had "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause to whatever extent this may be done with the force of that power behind it. . . ." (328 U.S. at 431.) We conclude that that decision, and other cases following it,[3] compel us to reject plaintiff's contention that the statutes herein involved are unconstitutional as affecting interstate commerce.

---

[3] See for example: *Prudential Ins. Co.* v. *Hobbs* (1946) 328 U.S. 822.

Finally, the Court of Appeal states (Appendix A, p. 33a):

The equal protection contention has been fully considered and rejected by a previous decision in this state in *Atlantic Ins. Co.* v. *State Bd. of Equalization* (1967) 255 Cal. App. 2d 1. Although that case involved the pre-1964 changes in the California Constitution, the decision dealt with both of the requirements of the provision as it then stood. After deciding that the Texas laws therein involved did discriminate against California insurers, the court discussed the issue of equal protection as related to the (second) comparative requirement. Relying in part on *Franklin Life Ins. Co.* v. *State Bd. of Equalization* (1965) 63 Cal. 2d 222, it was held that the comparative retaliatory tax did not violate the equal protection clause. Whether or not the court in *Atlantic* properly relied on *Franklin*, the decision was a square holding as to the equal protection issue, and not dictum, since, as we have said above, the pre-1964 California law required that both elements of the then constitutional provision be met before a retaliatory tax could be

assessed. The Supreme Court (of California) denied hearing in *Atlantic*. Right or wrong, we feel impelled to follow it in the case before us. It follows that, like the commerce clause contention, the equal protection contention must also fail.

## SUBSTANTIALITY OF FEDERAL QUESTIONS

This appeal raises substantial questions with respect to two constitutional provisions, the interstate commerce clause of Article I, Section 8 and the due process and equal protection clauses of the Fourteenth Amendment to the United States Constitution. The rationale of the two lower courts in each instance constituted an interpretation of the applicability of the federal Constitution to the California laws here attacked by Appellant. Does a California statute imposing a higher franchise tax (in the form of a retaliatory tax) on a foreign (Ohio) insurance company doing business in California than on a domestic insurance company, solely because Ohio's non-discriminatory taxes on insurance companies are higher than California's, impose a prohibited burden on interstate commerce or deny equal protection of the laws and due process of law? Does a California law denying to a foreign insurance company the same credit against the premium tax granted domestic companies for property taxes on their principal offices in California violate the same constitutional inhibitions? The answers to these two questions rest purely on the proper interpretation of the language of the United States Constitution.

The questions raised are substantial in the context of constitutional law, as evidenced by the erudite discussion of the trial court finding the laws unconstitutional and the discussion of the Court of Appeal reversing. They are substantial in relation to the scores of other foreign insur-

ance companies doing business in California who have been subjected to the same discrimination; and they are substantial in relation to the laws of many other states imposing comparative retaliatory taxes on foreign insurance companies in the same manner as California.[4]

Contrary to the decision of the Superior Court of Los Angeles County, the Court of Appeal felt that the issue of the burden on interstate commerce imposed by a comparative retaliatory tax had been decided by this Court in *Prudential Ins. Co.* v. *Benjamin,* 328 U.S. 408 (1946) and *Prudential Ins. Co.* v. *Hobbs,* 328 U.S. 822 (1946), and that the issue of equal protection of the laws had earlier been determined properly in favor of the taxing statute in the California Court of Appeal decision of *Atlantic Ins. Co.* v. *State Bd. of Equalization,* 62 Cal. Rptr. 784, 255 Cal. App. 2d 1 (1st Dist. 1967), *cert. denied,* 390 U.S. 529 (1968). The Court of Appeal erred on both counts. The *Benjamin* case, decided by this court in 1946, did not involve a retaliatory tax such as is in issue here; it involved a pure premium tax of 3% levied by South Carolina on foreign insurance companies as a condition to doing business in the state. The *Hobbs* case, which was a per curiam decision of this Court in 1946, a week after the *Benjamin* decision, involved not a *comparative* retaliatory tax but an *anti-discrimination* retaliatory tax and one which the Supreme Court of Kansas had found not to discriminate against foreign insurance companies. *In Re Insurance Tax*

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[4] At least 46 other states have retaliatory tax laws applicable to foreign insurance companies, and many of them are of the comparative type. (Pelletier, *Insurance Retaliatory Law,* 39 NOTRE DAME LAWYER 243 (1964)). These laws have a checkered past; 13 were repealed and 24 challenged by suit as unconstitutionally affecting interstate commerce after the *South-Eastern Underwriters* decision, *supra.* After passage of the McCarran-Ferguson Act and the *Benjamin* decision, most states reenacted their retaliatory statutes, and the challenges by suit were discontinued.

*Cases,* 161 P.2d 726, 734 (1945). The *Atlantic* case similarly involved the California anti-discrimination retaliatory tax in effect prior to the 1964 constitutional amendment, not a comparative retaliatory tax.

The Superior Court of Los Angeles County correctly stated (Memorandum of Intended Decision, Appendix A, p. 12a):

> Shorn of its dicta, the *Benjamin* case upheld a tax which the record therein failed to establish was discriminatory (328 U.S. at 428, fn. 36). It was not even a retaliatory tax. . . .

and with respect to *Hobbs* (Memorandum of Intended Decision, Appendix A, p. 13a):

> . . . This involved several Kansas taxes including a so-called "retaliatory tax" on out-of-state insurers similar in form, but not in effect, to that herein. The Kansas court rejected the contention that the tax discriminated against out-of-state insurers. To quote it:
>
> > Plaintiffs contend the tax in question is void because of discrimination between foreign and domestic insurance companies. It is true that domestic insurance companies are taxed on a different basis. They are not required to pay a tax measured by their premiums, but they are required to pay a capital stock tax . . . . and a tax upon the net assets . . .
> >
> > The fact that the tax on domestic companies is upon a different basis than that upon foreign companies does not of itself render the tax invalid. . . . We are unable to find in the record evidence to support the view that the tax in question upon foreign insurance companies is greater than that levied on the home insurance companies. [161 P.2d at 734].

And finally, with respect to the *Atlantic Insurance Co.*

case, (Memorandum of Intended Decision, Appendix A, p. 15a):

> . . . It involved 1959 and 1960 taxes when the law was the same as that governing the *Franklin Life* case and the same result was reached. At page 5 the opinion acknowledges that "the new statute would be unconstitutional if applied to a case where the discrimination . . . is not present". *See also* page 15.
>
> When the express reason for sustaining the constitutionality of California's retaliatory tax has been repealed and its effect is discriminatory, the resulting law is so different that these opinions do not support it. . . .

The Superior Court of Los Angeles County discussed the two types of retaliatory taxes — the anti-discrimination tax and the comparative tax (Memorandum of Intended Decision, Appendix A, p. 7a) — and pointed out:

> . . . that the objective described above of discouraging other states from imposing discriminatory taxes on California insurers is effectively served by the anti-discrimination retaliatory tax and is not served at all by the "comparative retaliatory tax." The tax involved herein is of the latter type. A "comparative retaliatory tax" is not really retaliatory at all. It does nothing to prevent discrimination by other states. It does not insure even-handed treatment by those states of California insurers. If anything, it would seem to stimulate counter discrimination against California carriers.

This Court has not spoken on the matter of retaliatory taxes on insurance companies since *Benjamin, supra,* and *Hobbs, supra,* in 1946, and it has never considered the validity of comparative retaliatory taxes. Furthermore, since the discussion by this Court in the *Benjamin* case of the McCarran-Ferguson Insurance Regulation Act (15

U.S.C. §§ 1011-1015 (1970)), this Court has successively narrowed the interpretation of the words "business of insurance" in sections 1 and 2 of that Act to enlarge the area of insurance company activity subject to federal regulation. See *SEC* v. *Variable Annuity Life Insurance Company,* 359 U.S. 65 (1959), holding that the sale of variable annuities was not the business of insurance; *SEC* v. *National Securities, Inc.,* 393 U.S. 453 (1969) in which this Court defined the "business of insurance" as the relationship between the insurer and the insured, the interpretation and enforcement of insurance policies and other activities relating to the companies' reliability as insurers; and *Group Life & Health Insurance Company* v. *Royal Drug Company,* 439 U.S. 813 (1979), in which this Court held that agreements between Blue Shield, a Texas insurance company, and participating pharmacies regulating the cost of prescription drugs to Blue Shield policyholders were not the "business of insurance" exempt from anti-trust statutes under Section 2 (b) of the McCarran Act. See also *Federal Regulation of Insurance Companies: The Disappearing McCarran Act Exemption,* 1973 DUKE LAW JOURNAL 1340.

Perhaps more pertinent, the more recent decisions by this Court in the field of state regulation of interstate businesses, including insurance companies, indicate a recognition of the applicability of other constitutional provisions to state taxation of foreign insurance companies.

These cases include *Wheeling Steel* v. *Glander, supra; Reserve Life Ins. Co.* v. *Bowers, supra,* and *WHYY, Inc.* v. *Glassboro, supra.* The *Reserve Life Ins. Co.* case directly supports Appellant's position. The insurance company alleged that the Ohio personal property tax law was invalid under the equal protection clause of the Fourteenth Amendment when it was levied on foreign insurance companies while domestic companies were ex-

empted from the tax by a provision that their franchise taxes were in lieu of all other taxes. This Court reversed the decision of the Ohio Supreme Court affirming the Court of Appeals decision that the law was valid. It is clear that for equal protection standards a classification of corporations based solely on domestic or foreign incorporation is improper.

## CONCLUSION

Appellant submits that the constitutional questions involved in this case are so substantial as to warrant plenary consideration, with briefs on the merits and oral argument, for their resolution.

Respectfully submitted,

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March 12, 1980

# APPENDIX A

---

SUPERIOR COURT OF CALIFORNIA,
COUNTY OF LOS ANGELES

---

Honorable A. R. Early, Judge
Thomas Pulce, Deputy Sheriff
M. E. Stipe, Deputy Clerk
Reporter, (None)

---

C-3189

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, a corporation

vs.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA

---

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*Appendix A*

Nature of Proceedings: Court's Intended Decision

In the above-entitled matter now submitted, judgment is for plaintiff for the full amount of tax refunds sought in accordance with the enclosed Memorandum Decision plus interest.

To dispose of all issues and avoid a possible retrial following appeal the court further finds as follows:

A. Plaintiff is barred from claiming that it should be treated herein as a California insurer because it failed to so claim in its claim for refund. R. & T. Code Section 13103. Cf. *American Chemical Corp.* vs. *County of Los Angeles* (1974) 42 C.A.3d 45 at 55-56, hearing denied, cert. den. 422 U.S. 1007.

B. To the extent that plaintiff's principal office deduction is allowed to plaintiff, its retaliatory tax will be correspondingly increased. The premium tax and the retaliatory tax are mutually interdependent.

C. The 1966 Amendment to California Constitution, Article XIII, Section 14-4/5 (e) and R. & T. Code Sec. 12441 were not intended by the law-makers to be retroactive and can not be applied to 1966 taxes. Cf. *Western & Southern Life Ins. Co.* vs. *State Board of Equalization* (1970) 4 C.A.3d 21, hearing denied, at 34-35.

The stipulation of facts on file herein is adopted as the court's findings of fact. Plaintiff is ordered to prepare appropriate conclusions of law and judgment, submit them to defendant for approval as to form and accuracy and then to the court for signature.

A copy of this minute order and a copy of the Memorandum Decision are mailed to all parties. A Certificate of Mailing is filed. MINUTES ENTERED Aug. 4, 1977

*Appendix A*

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

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Original Filed
August 4, 1977
County Clerk

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NO. C 3189

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, a corporation,

Plaintiff,

vs.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Defendant.

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## MEMORANDUM OF INTENDED DECISION

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This case involves the constitutionality of taxes paid under written protest by plaintiff for the years 1965-71 inclusive pursuant to Insurance Code Section 685 and Article XIII, Section 14-4/5 (f) (3) of the California Constitution as that section was amended November 3, 1964, effective 1965 (now renumbered as Article XIII, Section 28). It also involves the constitutionality of a portion of the premiums taxes paid under written protest by plaintiff

for the years 1966 through 1971 inclusive pursuant to Article XIII, Section 14-4/5 (e), as amended in 1966 so as to discriminate in favor of a "domestic insurer" as defined therein and against insurers incorporated outside of California in the credit allowed against the premiums tax known as the home office deduction.

The facts herein are stipulated. They are accurately condensed at pages 1 to 5 of plaintiff's opening brief (see defendant's trial brief at page 6, lines 5-7).

The tax imposed by Insurance Code Section 685 is referred to herein by both sides and in the Code as a "retaliatory tax," a confusing term because there are two different types of retaliatory tax. One type has been uniformly upheld by the appellate courts. This is a case of first impression dealing with the second type.

The plaintiff is an insurance carrier incorporated and having its principal office in Ohio. It has a Certificate of Authority for an indefinite term to do business in California issued pursuant to Insurance Code Section 701 which was effective July 1, 1956. Since that date, it has continually done business in this state. Prior to 1965, it constructed an office building on land it owns in this county, established its principal California office therein, and has so occupied it during all years pertinent herein.

## RETALIATORY TAX

Let us first examine the issue of the so-called "retaliatory tax." Following the Civil War, the insurance business expanded greatly and there were tremendous abuses. Regulation was needed, but there was no federal legislation to restrain the business. When state regulation was at-

tempted, it was attacked as a violation of the Commerce Clause of the U. S. Constitution. In *Paul* v. *Virginia,* 8 Wall. 168 (U.S. 1868), the United States Supreme Court permitted such state regulation to continue by holding that the insurance business was not commerce at all. *Accord*: *Hooper* v. *California* (1895) 155 U.S. 648, 655, and *New York Life Insurance Co.* v. *Deer Lodge County* (1913) 231 U.S. 495. A great number and variety of state taxes and regulations then developed, some of which strongly discriminated taxwise in favor of locally incorporated insurers as against those incorporated in other states but also doing business locally. As an antidote to such tax discrimination by other states against local insurers when doing business in those other states, local legislatures often adopted a "retaliatory tax" against out-of-state insurers when doing business locally. Writing under the direction of Prof. Robert E. Keeton in 39 Notre Dame Lawyer 243 (1964), George Pelletier, Jr., states that such statutes had then been adopted in 45 states, noting that they vary considerably in detail.

The purpose of such a retaliatory tax, according to defendant, "is to secure for the insurance companies of the enacting state even-handed treatment by the other states" (DTB 11, lines 11-14). This is a quotation from *Western & Southern Life Insurance Co.* v. *State Board of Equalization* (1970) 4 Cal. App. 3d 21, at 34. In *Atlantic Insurance Co.* v. *State Board of Equalization* (1967) 255 Cal. App. 2d 1 (hear. den.) cert. den. 390 U.S. 529, at page 4, the opinion states that "The common purpose of such legislation in the several states has been to discourage any state from imposing discriminatory taxes or other burdens upon out-of-state companies." And at page 15, the opinion says that "here the purpose of the retaliatory law is to secure

reciprocity (citations omitted) . . . . It is designed to achieve uniformity and not to discriminate."

The opinion in *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 Pac. 2d 726, affirmed (per curiam) in *Prudential Insurance Co. of America* v. *Hobbs* (1946) 328 U.S. 822, expressed the object of a retaliatory tax in similar terms: "It seems to us more justly to be deemed a provision for reciprocity. It says, in effect, that while we recommend all insurance corporations of other states to the transacion of business within our limits, we insist upon a like recommendation elsewhere, and that if other states shall attempt, directly or indirectly, to debar our corporations from the transaction of insurance business within their borders we shall meet their corporations with the same restrictions and disability. It is, in brief, an appeal for comity; a demand for equality" (161 Pac. 2d 730). Are these objectives served by the type of retaliatory tax before the court herein? We think not. Let us examine that tax.

That there are two different types of retaliatory tax was expressly recognized by the opinion in the *Atlantic Insurance Company* case, *supra,* at page 5. That opinion contrasted the retaliatory tax authorized by Article XIII Section 14-4/5 (f) (3) of the California Constitution as it read *before* it was amended November 3, 1964 with the different type of retaliatory tax authorized by Insurance Code Section 685. The Constitutional provision (now changed) then authorized tax retaliation against insurers from another state only when the tax laws of that state discriminated against California insurers in favor of its domestic insurers, thus giving its domestic insurers a competitive advantage over California insurers within its borders. Unless the context indicates otherwise, as used hereinafter the word "taxes" includes taxes, licenses, fees, and

other financial exactions in the aggregate. Section 685 on the other hand imposed a "retaliatory tax upon foreign insurance companies whose home states levied higher taxes upon California companies than California imposed upon companies from those foreign states" (irrespective of whether the foreign state discriminated against California companies or taxed them exactly the same as it did its domestic companies). The first type of tax is identified in the opinion as a "discriminatory tax," whereas the second is described as a "comparative retaliatory tax" (255 Cal. App. 2d 5). A term more descriptive of the first type, which I will hereinafter use, would be an "anti-discrimination retaliatory tax." It is obvious that the objective described above of discouraging other states from imposing discriminatory taxes on California insurers is effectively served by the anti-discrimination retaliatory tax and is not served at all by the "comparative retaliatory tax." The tax involved herein is of the latter type. A "comparative retaliatory tax" is not really retaliatory at all. It does nothing to prevent discrimination by other states. It does not insure even-handed treatment by those states of California insurers. If anything, it would seem to stimulate counter discrimination against California carriers.

In 1944 the U. S. Supreme Court overturned its 1868 decision in *Paul* v. *Virginia, supra,* and in *United States* v. *South-Eastern Underwriters Association* (1944) 322 U.S. 533 it was held that insurance was commerce after all, and could be interstate commerce. Congress, however, did not then undertake to exercise its power under the Commerce Clause to regulate the interstate insurance business. Instead, it enacted the McCarran-Ferguson Act (59 Stat. 33; 15 U.S.C. Sections 1011-1015) which returned authority to regulate and tax the insurance industry to the states. As

the Act did not purport to repeal any part of the United States Constitution, the authority of the states is, of course, limited by that Constitution's constraints. Just what limits does the federal Constitution place upon the power of the states to tax interstate commerce? One percipient scholar and legal satirist, the late Professor T. Reed Powell, once said that if the American Law Institute were to restate the law of state taxation of interstate commerce, it would read as follows:

> **State Power to Tax Interstate Commerce**
>
> The states may tax interstate commerce.
>
> Comment: The states may not tax interstate commerce too much.
>
> Caveat: How much is too much is beyond the scope of this restatement.

Professor Powell was echoing the laments of members of the Court itself epitomized in the opinion in *Portland Cement Co.* v. *Minnesota* (1959) 358 U.S. 450, at 457-458:

> "Commerce between the States having grown up like Topsey, the Congress meanwhile not having undertaken to regulate taxation of it, and the States having understandably persisted in their efforts to get some return for the substantial benefits they have afforded it, there is little wonder that there has been no end of cases testing out state tax levies. The resulting judicial application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation. This Court alone has handed down some three hundred full-dress opinions spread through slightly more than that number of our reports. As

> was said in *Miller Bros. Co.* v. *Maryland,* 347 US 340, 344, 98 L ed 744, 748, 74 S Ct 535 (1954), the decisions have been 'not always clear . . . consistent or reconcilable. A few have been specifically overruled, while others no longer fully represent the present state of the law.' From the quagmire there emerge, however, some firm peaks of decision which remain unquestioned."

In *Prudential Ins. Co.* v. *Benjamin* (1946) 328 U.S. 408, 420, the opinion summarizes the situation as "one of very considerable judicial oscillation." However, even in that era of uncertainty, as stated in *Portland Cement, supra,* there were "some firm peaks of decision which remain unquestioned." Significant herein among those landmarks is the principle that "no State may impose a tax which discriminates against interstate commerce . . . . by providing a direct commercial advantage to local business" (citing cases) (358 U.S. at 458). *Accord: Richfield Oil Corp.* v. *State Board of Equalization* (1946) 329 U.S. 69, at 76, and *Hanover Fire Insurance Co.* v. *Harding* (1926) 272 U.S. 494. This language was quoted approvingly by a unanimous court in *Boston Stock Exchange* v. *State Tax Commission* (1977) 50 L.ed. 2d 514 at 524. The reason behind the rule was simply stated:

> ". . . the very purpose of the Commerce Clause was to create an area of free trade among the several states. . . . The prohibition against discriminatory treatment of interstate commerce follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses would invite a multiplication of preferential trade areas destructive of the free trade which the Clause protects."

Cases to this effect are legion. Even Alexander Hamil-

ton wrote, "An unrestrained intercourse between the States themselves will advance the trade of each, by an interchange of their respective productions, not only for the supply of reciprocal wants at home, but their exportation to foreign markets." THE FEDERALIST No. 11, at 52 (Cooke ed. 1961).

Another recognized landmark is the principle that a state may tax interstate commerce so that it will carry "its fair share of the costs of state government in return for the benefits" and services it derives from the state. *Richfield Oil Corporation* v. *State Board of Equalization, supra,* 329 U.S. at 75. *Portland Cement Co.* v. *Minnesota, supra,* 358 U.S. at 462. *Complete Auto Transit, Inc.* v. *Brady* (1977) 51 L.ed. 2d 326 at 336.

In other words, "Interstate commerce may be made to pay its way."

The retaliatory taxes herein were levied pursuant to Insurance Code Section 685 and California Constitution Art. XIII, Section 14-4/5 (f) (3) as amended November 3, 1964, upon plaintiff, an insurance carrier incorporated in Ohio. During none of the years pertinent herein did Ohio discriminate against California carriers doing business in Ohio; Ohio imposed the same burdens and taxes on its domestic insurers that it did on California carriers doing business in Ohio. Ohio apparently had a retaliatory tax similar to California's which never became applicable herein because the taxes and burdens Ohio imposed on companies doing business in Ohio were greater than those imposed by California on its domestic insurers.

During this period, the California retaliatory tax was of the type described in the *Atlantic Ins. Co.* case, *supra,* at page 5 as a "comparative retaliatory tax." California im-

posed its premiums tax upon plaintiff each year and in addition thereto imposed a "retaliatory tax" which represented the difference between the California premiums tax paid by plaintiff and the aggregate taxes that a California company would have had to pay in Ohio upon the same volume of business done therein. The California premiums tax is an "in lieu" tax and, except for real property taxes (which are also paid by foreign carriers), *no other taxes were imposed by California on its own domestic carriers.* Recognition of this fact is essential to the finding that the California retaliatory tax discriminates against the plaintiff herein. As amended on November 3, 1964, the California Constitution no longer requires that Ohio discriminate against California insurers doing business in Ohio before California's "retaliatory tax" becomes applicable. This California tax is plainly discriminatory against interstate commerce. No reasonable ground for this discriminatory classification has ever been suggested. The tax has no relationship whatsoever to the benefits or services that the state furnishes a foreign carrier. It is a burden on interstate commerce which directly affects it by making it more costly relative to similar intrastate commerce which does not bear this burden. Tax discrimination is equally onerous whether cast in the form of a license tax, a property tax, a premium tax, an income tax, or a franchise tax. It provides a direct commercial advantage to domestic businesses at the expense of out-of-state businesses.

No California court has ever squarely upheld such a discriminatory tax. No federal court has ever upheld a "comparative retaliatory tax" where it was proved that the effect of that tax was discriminatory.

Defendant argues that California has the power to impose a discriminatory tax upon foreign corporations as a

condition of their right to continue to do business in California. Let us examine some of these cases upon which defendant relies.

*Prudential Ins. Co.* v. *Benjamin* (1946) 328 U.S. 408 upheld a premiums tax imposed by South Carolina on out-of-state insurers but not imposed on domestic insurers. Viewed in isolation, this appears to be discriminatory. However, South Carolina denied discrimination (at 411, 412) and the opinion recites that the record did not establish that the tax was discriminatory in effect when the other taxes paid by domestic carriers but not paid by out-of-state carriers were considered (fn. 36, 3rd paragraph). The Court, however, "assumed" that the tax would be discriminatory in certain other senses (at 428, fn 36 and fn 4). It nevertheless upheld the tax on the ground the Congress had consented thereto in the McCarran-Ferguson Act, simultaneously acknowledging that Congress had no power "to subvert constitutional limitations" (at 430).

The tax upheld was not a so-called "retaliatory tax" of either type. The opinion expressly disclaimed approval of such a tax. In fn 40, it referred to allegedly similar tax statutes of sixteen other states and said that "We express no opinion concerning the validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein." A retaliatory tax hardly qualifies as "substantially identical."

Shorn of its dicta, the *Benjamin* case upheld a tax which the record therein failed to establish was discriminatory (328 U.S. at 428, fn. 36). It was not even a retaliatory tax. This undermines the conclusion (perhaps an inadvertence) expressed in the opinion in *Franklin Life Ins. Co.* v. *State Board of Equalization* (1965) 63 Cal. 2d 222 in fn.

2. It is also self evident that by the McCarran-Ferguson Act, Congress could not effectively consent to state taxation which violates the due process clause of the United States Constitution. Even the *Franklin Life* opinion acknowledges (63 Cal. 2d at 226) that "Of course, any attempt to assess a retaliatory tax against an insurer from a state which does not discriminate against California insurers, would constitutionally fail." Amen! This statement is echoed at page 5 of the opinion in *Atlantic Ins. Co.* v. *State Board of Equalization* (1967) 255 Cal. App. 2d 1 (hear. den.), cert. den. 390 U.S. 529.

Defendant relies on *In Re Insurance Tax Cases* (1945) 160 Kan. 300, 161 Pac. 2d 726 which was affirmed (per curiam) shortly after the *Benjamin* decision sub. nom. *Prudential Ins. Co.* v. *Hobbs* (1946) 328 U.S. 822. This involved several Kansas taxes including a so-called "retaliatory tax" on out-of-state insurers similar in form, but not in effect, to that herein. The Kansas court rejected the contention that the tax discriminated against out-of-state insurers. To quote it:

> "Plaintiffs contend the tax in question is void because of discrimination between foreign and domestic insurance companies. It is true that domestic insurance companies are taxed on a different basis. They are not required to pay a tax measured by their premiums, but they are required to pay a capital stock tax . . . . and a tax upon the net value of their assets . . . The fact that the tax on domestic companies is upon a different basis than that upon foreign companies does not of itself render the tax invalid . . . . We are unable to find in the record evidence to support the view that the tax in question upon foreign insurance companies is greater than that levied on the home insurance companies." (166 Pac. 2d at 734).

The approach taken by the Kansas court has recently

been approved. Referring with approval to earlier opinions cited in fn. 8, in *Complete Auto Transit, Inc.* v. *Brady* (1977) 51 L.ed. 2d 326, the unanimous opinion notes that "these decisions have considered not the formal language of the tax statute, but rather its practical effect . . . ." (at 331). At the same page, the opinion notes that the permissibility of state taxation is "based on the actual effect rather than its legal terminology." Even the *Benjamin* opinion at page 420 states that in resolving these problems there should be "emphasis on facts rather than dogmatic logistic." Or, as Chief Justice Taft put it at page 510 of the opinion in *Hanover Fire Ins. Co.* v. *Harding* (1926) 272 U.S. 494, ". . . the decision is not dependent upon the form in which the taxing scheme is cast . . . . We must regard the circumstances rather than the form."

Approval by the United States Supreme Court of nondiscriminatory taxes in the *Benjamin* and *Hobbs* cases gives little support to defendant's contentions.

We have already mentioned the *Franklin Life Ins. Co.* case, *supra*. That opinion dealt with 1960 retaliatory taxes. At that time, the California Constitution, Art. XIII, Section 14-4/5 (f) permitted such taxes only against "foreign insurers of states discriminating against California insurers" (63 Cal. 2d 222 at 226; also see 233). It does not support such a tax against insurers from states like Ohio which do not discriminate against California insurers. To the contrary, at page 226 the opinion states that ". . . any attempt to assess a retaliatory tax against an insurer from a state which did not discriminate against California insurers would constitutionally fail."

*Atlantic Insurance Co.* v. *State Board of Equalization* (1967) 255 Cal. App. 2d 1 (hear. den.) cert. den., is also

relied upon by defendant. It involved 1959 and 1960 taxes when the law was the same as that governing the *Franklin Life* case and the same result was reached. At page 5 the opinion acknowledges that "the new statute would be unconstitutional if applied to a case where the discrimination . . . is not present." *See* also page 15.

When the express reason for sustaining the constitutionality of California's retaliatory tax has been repealed and its effect is discriminatory, the resulting law is so different that these opinions do not support it. *Western & Southern Life Insurance Co.* v. *State Board of Equalization* (1970) 4 Cal. App. 3d 21 (hear. den.) involved 1964 retaliatory taxes. Before 1964, the California Constitution had imposed a premiums tax on foreign and domestic insurers alike. When the tax laws of another state discriminated against California insurers in favor of its domestic insurers, California also imposed retaliatory taxes on insurers from that state doing business in California. Effective November 4, 1964, the California Constitution was amended to eliminate the discrimination requirement and thereafter imposed the tax on a foreign insurer when its state of incorporation taxed California insurers more than California would have done – even in the absence of any discrimination by that state. The opinion held that the amendment could not be applied retrospectively and therefore could not be considered in determining 1964 taxes. Dicta in the opinion (at page 30) states that "The California retaliatory tax law does not violate . . . the United States Constitution." The opinion fails to distinguish between the pre-1964 anti-discrimination retaliatory tax and the post-1964 comparative retaliatory tax. It fails to note that the cases cited have upheld taxes only when no discriminatory effect was proved. It also cites the *Atlantic*

*Insurance Co.* case, altogether ignoring the statement therein that "the new statute would be unconstitutional if applied to a case where the discrimination . . . is not present" (255 Cal. App. 2d 1 at 5).

We are persuaded that the more authoritative and convincing dicta is that noted above from *Franklin Life Insurance Co.* v. *State Board of Equalization* (1965) 63 Cal. 2d 222 at 226. We find that the retaliatory tax herein is discriminatory in fact and violates both the due process and commerce clauses of the United States Constitution.

**Principal Office Deduction from the Gross Premiums Tax**

The second tax involved herein is the gross premiums tax levied pursuant to former California Constitution, Art. XIII Section 14-4/5 (f) (3) which was imposed upon all insurers, out-of-state and domestic, in lieu of all other taxes and licenses except real estate taxes. Plaintiff does not challenge the basic tax. It challenges the denial (pursuant to the 1966 amendment) to it as an out-of-state insurer of the credit against that tax for the payment of local real property taxes, which credit is granted to domestic insurers.

That this principal office deduction was altogether repealed in 1976 is irrelevant herein.

Denial of this credit to plaintiff solely because it is an out-of-state insurer obviously creates a "direct commercial advantage to local business." It is a backhanded way of granting a property tax exemption to domestic insurers while denying it to out-of-state insurers. It invokes the rule that where a taxpayer's federal constitutional rights are concerned, the courts will not be governed by the label that a state attaches to a taxing device (here a privilege

tax) but by the practical consequences of the tax measured against constitutional standards.

Obviously such a discriminatory credit for other taxes paid could not stand constitutional testing if applied to an income tax, or to a gross receipts tax. Nor is discriminatory property taxation permitted.

Defendant seeks to sustain this tax credit because the tax upon which it is applied analytically is a franchise tax or a privilege tax. It remains a tax in lieu of income taxes; why should it have different legal consequences?

Defendant argues that this tax credit is valid, that California may discriminatorily tax an out-of-state corporation as a condition for the privilege of doing business in California. The more recent decisions of the United States Supreme Court do not support this contention. For background material see the illuminating discussion of *Unconstitutional Conditions* in 73 Harvard L.R. 1595 (1960) at 1605-1609.

Quite recently the unanimous opinion of the United States Supreme Court in *Complete Auto Transit, Inc.* v. *Brady* (1977) 51 L.ed. 2d 326 at 337 held that "There is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect." Ignoring the form in which the principal office deduction is cast and focusing attention on whether it produces a "forbidden effect," we find such an effect – discrimination against interstate commerce because it is interstate commerce.

Thirty years ago in *Freeman* v. *Hewit* (1946) 329 U.S. 249 at 252 the United States Supreme Court said, with

reference to the many opinions that are pertinent to this subject, "To attempt to harmonize all that has been said in the past would neither clarify what has gone before nor guide the future." This court is encouraged by the readiness with which the United States Supreme Court has recently overturned some of the historically unsound and illogical precedents in the field of state taxation. Just this year *Spector Motor Service* v. *O'Connor* (1951) 340 U.S. 602 was specifically and unanimously overruled by *Complete Auto Transit, Inc.* v. *Brady, supra.* Just last year, in *Michelin* v. *Wages* (1976) 423 U.S. 276 the court unanimously overruled *Low* v. *Austin* (1872) 80 U.S. (13 Wall.) 29. Thus encouraged, and with the original purposes of the due process, equal protection and commerce clauses in mind, and following the more recent reasoning and analysis of these matters by our highest court, this court concludes that the denial by defendant to plaintiff of the principal office deduction is an unconstitutional discrimination, that the California constitutional provision and statute mandating such denial violates the United States Constitution and that, therefore, plaintiff is entitled to that credit for all tax years pertinent herein.

DATED: August 4, 1977.

/s/ A. R. EARLY
JUDGE OF THE
SUPERIOR COURT

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, a corporation,

Plaintiff,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Defendant.

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No. C 3189

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*Appendix A*

## CONCLUSIONS OF LAW

The above entitled cause came on regularly for trial on June 10, 1977, in Department 15 of the above entitled court, the Honorable Alexander R. Early, Judge presiding, plaintiff The Western and Southern Life Insurance Company appearing by Messrs. Kyte, Conlan, Wulsin & Vogeler by Alan R. Vogeler, Esq. and by Messrs. Paul, Hastings, Janofsky & Walker by Ronald M. Oster, Esq., and defendant State Board of Equalization of the State of California appearing by Evelle J. Younger, Attorney General of California, by Timothy G. Laddish, Esq., and the parties having agreed to a Stipulation of Facts, and trial briefs having been filed by the parties' respective counsel, and the cause having been argued and submitted for decision, the court, having adopted the parties Stipulation of Facts as its written Findings of Fact, does hereby make in writing its Conclusions of Law, as follows:

1. The carrying on within a state of an insurance business by a corporation incorporated in another state constitutes interstate commerce.

2. The authority to regulate and tax the insurance industry given to the states by the McCarran-Ferguson Insurance Regulation Act, 59 Stat. 33, 15 U.S.C. §§ 1011-15, could not and did not eliminate the restraints on state action in the Constitution of the United States.

3. While a state may tax interstate commerce so that it carries its fair share of the costs of state government in return for the benefits and services it derives from the state, no state may impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business.

4. Prior to November 3, 1964 California authorized tax retaliation against insurers from another state only when the tax laws of that state discriminated against California insurers in favor of its domestic insurers, thus giving the latter a competitive advantage over California insurers within its borders. This type of law can appropriately be called an "anti-discrimination retaliatory tax."

5. The amendment of Article XIII, Section 14-4/5 (f) (3) of the California Constitution on November 3, 1964 purported to authorize and Insurance Code Section 685 imposed tax retaliation against insurers from another state in the years here involved when the laws of that state levied higher taxes upon California insurers doing business in that state than California imposed upon insurance companies from that state doing business in California, irrespective of whether the other state discriminated against California companies or taxed them exactly the same as it did its domestic companies. This type of law appropriately has been called a "comparative retaliatory tax".

6. The objective of California retaliatory taxes is to discourage other states from imposing discriminatory taxes on California insurers. That objective is effectively served by an "antidiscrimination retaliatory tax" and is not served at all by the "comparative retaliatory tax".

7. In none of the years here pertinent did the State of Ohio discriminate against California insurance companies doing business in Ohio, imposing the same burdens and taxes on its domestic insurers that it imposed on California insurance companies doing business in Ohio.

8. Section 685 of the California Insurance Code and Article XIII Section 14-4/5 (f) (3) of the California Con-

stitution impose a comparative retaliatory tax which neither prevents discrimination by other states nor insures even-handed treatment by those states of California insurers.

9. The California retaliatory tax as effective for the years 1965 and following discriminates against insurers from other states, including Ohio, thereby providing a direct commercial advantage to local business and discriminated against interstate commerce, and, therefore, violates both the due process and commerce clauses of the United States Constitution.

10. The denial to a foreign insurer of a credit against the California premiums tax for real property taxes paid in California on the principal office in California of such foreign insurer under the 1966 amendment to Article XIII Section 14-4/5 (e) of the California Constitution and the 1967 amendment to Revenue and Taxation Code Section 12241 grants a property tax exemption to domestic insurers while denying it to an out-of-state insurer. This change in the law was not intended to be retro-active and is inapplicable to 1966 taxes.

11. The gross premiums tax imposed by Article XIII, Section 14-4/5 of the California Constitution on insurers doing business in the State of California is in lieu of all other taxes except real estate taxes.

12. Article XIII, Section 14-4/5 (e) of the California Constitution, together with Section 12241 of the California Revenue and Taxation Code purported to grant a credit against the gross premiums tax to local insurers for real estate taxes paid to the State of California while denying such a credit to out-of-state insurers.

13. Granting such a credit to local insurers while

denying such a credit to out-of-state insurers discriminates against interstate commerce by creating a direct commercial advantage to local business.

14. Just as a discriminatory credit for taxes paid constitutionally would fail as applied to an income tax or a gross receipts tax, so also it is unconstitutional as applied to property taxation.

15. Irrespective of whether the gross premiums tax may be characterized as a franchise or privilege tax, it remains a tax in lieu of income taxes and discrimination in such a tax has the same legal consequences as discrimination in an income tax.

16. Discrimination in granting a credit for real estate taxes against the gross premiums tax is prohibited by the due process and equal protection clauses of the Fourteenth Amendment to, and by the commerce clause of Article I, Section 8, Clause 3, of the United States Constitution.

17. The gross premiums tax imposed by Article XIII, Section 14-4/5 of the California Constitution and the retaliatory tax imposed by Article XIII, Section 14-4/5 (f) (3) and Section 685 of the California Insurance Code are mutually interdependent, and to the extent that a credit against the gross premiums tax is allowed, the retaliatory tax is correspondingly increased.

18. Sections 12432 and 12290 of the California Revenue and Taxation Code do not bar the collection of additional retaliatory taxes not assessed by the state within the period set forth therein when an out-of-state insurer successfully contests the assessment of a portion of the gross premiums tax and secures a reduction in such assessment.

19. Plaintiff is barred from claiming that it should

be treated as a California insurer because it failed to raise this issue in its claim for refund.

20. Plaintiff is entitled to judgment for the full amount of tax refunds sought, plus interest as provided by statute.

DATED: .....

.....

Judge of the Superior Court

Approved as to form and conformity
with Memorandum of Intended Decision
and Minute Order, filed August 4, 1977.

PAUL, HASTING, JANOFSKY & WALKER

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Attorneys for plaintiff THE WESTERN
AND SOUTHERN LIFE INSURANCE COMPANY

SUPERIOR COURT OF THE STATE OF
CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

---

Filed October 27, 1977

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THE WESTERN AND SOUTHERN LIFE
INSURANCE COMPANY, a corporation,
Plaintiff,

v.

STATE BOARD OF EQUALIZATION OF
THE STATE OF CALIFORNIA,
Defendant.

---

No. C 3189

---

## JUDGMENT

IT IS ORDERED ADJUDGED AND DECREED that plaintiff The Western and Southern Life Insurance Company have judgment against defendant State Board of Equalization of the State of California in the sum of $977,853.57, together with costs, and interest (at the rate of 6 percent per annum through December 31, 1975, and at the rate of 12 percent per annum thereafter) computed pursuant to section 13107 of the Revenue and Taxation Code on the following amounts from the following dates: on $128,214.90 from November 25, 1966; on $78,042.57 from July 14, 1967; on $52,517.91 from November 24, 1967; on $3,072.38 from March 15, 1968; on $72,900.38 from June 10, 1968; on $60,270.01 from November 29, 1968; on $81,917.80 from October 13, 1969; on $65,390.47 from November 21, 1969; on $81,576.55 from March 26, 1970; on $66,265.56 from November 30, 1970; on $76,-446.55 from March 29, 1971; on $67,639.12 from November 23, 1971; on $78,164.41 from March 27, 1972; and on $65,434.96 from November 27, 1972.

DATED: 27 October 1977

/s/ A. R. EARLY
Judge of the Superior Court

Approved as to form and conformity
with Memorandum of Intended Decision
and Minute Order, filed August 4, 1977.

PAUL, HASTINGS, JANOFSKY & WALKER
By: /s/ RONALD M. OSTER
Attorneys for Plaintiff

EVELLE J. YOUNGER
By: /s/ TIMOTHY G. LADDISH
Attorneys for Defendant

*Appendix A*

CERTIFIED FOR PUBLICATION

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IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FOUR

---

2 Civ. No. 55251
(Super Ct. No. C-3189)

---

THE WESTERN AND SOUTHERN
LIFE INSURANCE COMPANY,

Plaintiff and Respondent,

v.

STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA,

Defendant and Appellant.

---

(Filed November 2, 1979)

---

APPEAL from a judgment of the Superior Court, Los Angeles County. Alexander R. Early III, Judge. Reversed.

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George Deukmejian, Attorney General, Ernest P. Goodman, Assistant Attorney General, and Timothy G. Laddish, Deputy Attorney General, for Defendant and Appellant.

Frost & Jacobs, Alan R. Vogeler, Gerald L. Baldwin, Paul, Hastings, Janofsky & Walker, and Ronald M. Oster for Plaintiff and Respondent.

This case involves the constitutionality of two provisions of California law imposing taxes on foreign insurance companies. The trial court found in favor of the plaintiff insurance company, holding that one of those provisions (the so-called retaliatory tax) was unconstitutional. It also made findings on other issues as set forth in its memorandum of intended decision as follows:

"In the above-entitled matter now submitted, judgment is for plaintiff for the full amount of tax refunds sought in accordance with the enclosed Memorandum Decision plus interest.

"To dispose of all issues and avoid a possible retrial following appeal the court further finds as follows:

"A. Plaintiff is barred from claiming that it should be treated herein as a California insurer because it failed to so claim in its claim for refund. R. & T. Code Section 13103. Cf. *American Chemical Corp.* v. *County of Los Angeles* (1974) 42 C.A.3d 45 at 55-56, hearing denied, cert. den. 422 U.S. 1007.

"B. To the extent that plaintiff's principal office deduction is allowed to plaintiff, its retaliatory tax will be correspondingly increased. The premium tax and the retailatory [sic] tax are mutually interdependent.

"C. The 1966 Amendment to California Constitution, Article XIII, Section 14-4/5 (e) and R. & T. Code Sec. 12441 were not intended by the law-makers to be retroactive and can not be applied to 1966 taxes. Cf *Western & Southern Life Ins. Co.* v. *State Board of Equalization* (1970) 4 C.A.3d 21, hearing denied, at 34-35.

"The stipulation of facts on file herein is adopted as the court's findings of fact. Plaintiff is ordered to pre-

pare appropriate conclusions of law and judgment, submit them to defendant for approval as to form and accuracy and then to the court for signature."

The case was submitted on a stipulation of facts. They may be summarized as follows:

Plaintiff is an Ohio corporation, licensed in 1956 to do business in California. While its principal office is in Ohio it owns a building in Los Angeles which it utilizes as its principal office for California. Approximately 76% of that building is leased by it to tenants not connected with the operations of plaintiff. The taxes imposed by Ohio, on a California corporation doing business in Ohio, exceed the taxes imposed on foreign corporations doing business in California, under the basic premium tax imposed by California. The "retaliatory tax" herein involved imposes on plaintiff (and similar insurers) an additional tax equal to that difference. It is the validity of that additional tax that is the principal issue in this case.

Prior to 1966, California allowed an insurance company to deduct from its premium tax, the amount of local property tax imposed on its principal office in this state; by an amendment in that year, the real property tax deduction was amended so that foreign insurers,[1] but not domestic insurers, were limited to a deduction equal only to the proportion of such taxes attributable to the portion of the home office building used by the insurer. The effect, therefore, was to impose on a foreign insurer a larger premium tax than that imposed on domestic insurers.

---

[1] As used herein, and in the literature on the subject, a "foreign" insurance company is one incorporated and having its principal office in a state other than the state imposing the taxes; a "domestic" insurance company is one incorporated in, and having its principal office, in the state imposing the taxes.

*Appendix A*

I

Retaliatory taxes, in some form, exist in at least 49 states. The purpose, as set forth in many cases and in the literature discussing them, is to put pressure on the several states to impose the same tax burden on all insurance companies, foreign or domestic, and thereby encourage the doing of interstate business.

Prior to 1964, the California Constitution provided for a retailatory [sic] tax involving two elements: a tax on *discriminatory* taxes, i.e., taxation of a California insurer doing business in the home state of a foreign insurer, at a higher rate than that state imposed on its own insurers; and (2) a tax on *comparative* taxes such as the one herein involved. At that time, the statutory law imposed a retailatory [sic] tax only on the comparative theory. In 1964, the California Constitution was amended to delete the provision relating to discriminatory taxes and thereafter both the California Constitution and the statute used parallel language imposing only the comparative tax.

In cases involving the applicability of the pre-1964 tax scheme, the courts held that, because the California Constitution required that a tax imposed by the home state of a foreign insurer involve both the discriminatory and the comparative feature, the statutory attempt to impose a retaliatory tax in situations involving only the comparative tax was invalid as being beyond the California constitutionally granted power of taxation.[2] We agree with plaintiff that the *holding* of those cases was limited to that issue, although there is language, relied on here by de-

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[2] *Franklin Life Ins. Co.* v. *State Bd. of Equalization* (1965) 63 Cal. 2d 222; *Atlantic Ins. Co.* v. *State Bd. of Equalization* (1967) 255 Cal. App.2d 1.

fendant, that can be read as sustaining the constitutionality of the present comparative provisions. We turn then, to consider the issue herein involved with no binding California precedent, although the language relied on by defendant is, of course, entitled to our respect.

For many years, under the compulsion of *Paul* v. *Virginia* (1868) 75 U.S. (8 Wall.) 168, which had held that the business of insurance was not "commerce" within the meaning of the Commerce Clause of the federal Constitution, the states had imposed a variety of retaliatory taxes. In 1944, in *United States* v. *South-Eastern Underwriters Assn.* (1944) 322 U.S. 533, the Supreme Court overruled *Paul* v. *Virginia* and held that the business of insurance was within the commerce clause. Shortly thereafter, Congress enacted the so-called McCarran Act (59 Stats. 33, 15 U.S.C. §§ 1011-1015). That statute provided that "the business of insurance . . . shall be subject to the law of the several States which relate to the regulation or taxation of such business." In *Prudential Ins. Co.* v. *Benjamin* (1946) 328 U.S. 408, the Supreme Court construed that statute and concluded that Congress had "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause to whatever extent this may be done with the force of that power behind it. . . ." (328 U.S. at 431.) We conclude that that decision, and other cases following it,[3] compel us to reject plaintiff's contention that the statutes herein involved are unconstitutional as affecting interstate commerce.

---

[3] See, for example: *Prudential Ins. Co.* v. *Hobbs* (1946) 328 U.S. 822.

## II

However, *Benjamin* also made it clear that the McCarran Act did not insulate state legislation from attack on grounds other than the commerce clause. In that connection, the Supreme Court said (at p. 430) :

"Nor is it necessary to conclude that Congress, by enacting the McCarran Act, sought to validate every existing state regulation or tax. For in all that mass of [state] legislation must have lain some provisions which may have been subject to serious question on the score of other constitutional limitations in addition to commerce clause objections arising in the dormancy of Congress' power. And we agree . . . that there can be no inference that Congress intended to circumvent constitutional limitations on its own power."

Thus we turn to plaintiff's alternative contention, i.e., that the retaliatory taxes violate the due process and equal protection clauses of the Fourteenth Amendment.[4]

We note first that, after the cautionary statement above quoted, the Supreme Court turned to consideration of the contentions that the retaliatory tax there before it did violate some other constitutional restriction. It said (at pp. 437-438) :

"These arguments may be summarily disposed of. As for the due process contention, it was settled by a long line of authorities prior to the *South-Eastern* decision, that the . . . provision of the Fourteenth Amendment, as well

---

[4] Although the contention is stated as involving both provisions, the discussions in the briefs are limited to the equal protection contention. We discuss the problem in that light.

as that requiring equal protection of the laws, does not forbid the states to lay and collect such a [retaliatory] tax. . . ."

The equal protection contention has been fully considered and rejected by a previous decision in this state in *Atlantic Ins. Co.* v. *State Bd. of Equalization* (1967) 255 Cal.App.2d 1. Although that case involved the pre-1964 changes in the California Constitution, the decision dealt with both of the requirements of the provision as it then stood. After deciding that the Texas laws therein involved did discriminate against California insurers, the court discussed the issue of equal protection as related to the (second) comparative requirement. Relying in part on *Franklin Life Ins. Co.* v. *State Bd. of Equalization* (1965) 63 Cal.2d 222, it was held that the comparative retaliatory tax did not violate the equal protection clause. Whether or not the court in *Atlantic* properly relied on *Franklin,* the decision was a square holding as to the equal protection issue, and not dictum, since, as we have said above, the pre-1964 California law required that *both* elements of the then constitutional provision be met before a retaliatory tax could be assessed. The Supreme Court denied hearing in *Atlantic.* Right or wrong, we feel impelled to follow it in the case before us. It follows that, like the commerce clause contention, the equal protection contention must also fail.

## III

The second major issue raised by this appeal relates to the calculation of the head office tax deduction.[5] That

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[5]The entire home office deduction was repealed in 1976.

issue has, so far as we can discover, never been litigated in any earlier California case.

The Board argues that the effect of increasing the home office exemption to plaintiff would merely increase, pro tanto, the retaliatory tax payable for that year. Since the amount of the retaliatory tax is the difference between the premium tax paid to California and the comparable tax payable in plaintiff's home state, that contention is correct. It follows that, even if plaintiff is correct in its attack on the constitutionality of the home office exemption, the amount that it paid was correct. Plaintiff's argument here seeks to avoid that result by treating the gross premium tax and the retaliatory tax as separate and arguing that, if it has overpaid the former and underpaid the latter, it is entitled to a refund on its timely claim for overpaid premium tax and the state is barred by section 12342 of the Revenue and Taxation Code from making a late assessment for underpaid retaliatory tax. This theory misses the reality of the California tax on insurers. The two provisions are but parts of a single taxation scheme. Unless plaintiff has, in the end, paid no more than the scheme required, it is not entitled to any refund.

The judgment is reversed.

*CERTIFIED FOR PUBLICATION.*

KINGSLEY, J.

We concur:

FILES, P.J.
ALARCON, J.

*Appendix A*

CERTIFIED FOR PUBLICATION

---

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FOUR

---

2 Civ. No. 55251
(Super Ct. No. C-3189)

---

THE WESTERN AND SOUTHERN
LIFE INSURANCE COMPANY,
Plaintiff and Respondent,

v.

STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA,
Defendant and Appellant.

---

**ORDER MODIFYING OPINION AND
DENYING REHEARING**
(Filed November 28, 1979)

THE COURT:*

(1) The opinion heretofore filed in the above entitled case on November 3, 1979, is hereby modified as follows:

(a) In line 10 on page 10 of the Xerox opinion, [line 20, page 32a, herein] delete the word "retaliatory."

---

* FILES, P. J.; KINGSLEY, J.

(b) In footnote 3 on page 9 of the Xerox opinion [page 31a, herein] add the following: The tax involved in *Hobbs* has been held to be "substantially identical to Insurance Code section 685." (*Atlantic Ins. Co.* v. *State Board of Equalization* (1967) 255 Cal.App.2d 1, 10.)

(c) In line 13 on page 13 of the Xerox opinion, [line 21, page 34a herein] delete the word "no."

(2) The petition for rehearing is denied.

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CLERK'S OFFICE, SUPREME COURT
4250 STATE BUILDING
San Francisco, California 94102

Dec. 27, 1979

I have this day filed Order

HEARING DENIED

In re: 2 Civ. No. 55251
Western and Southern Life Ins. Co.

vs.

State Board of Equalization

Respectfully,

G. E. BISHEL
Clerk

## APPENDIX B

IN THE COURT OF APPEAL
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT

---

2nd Civil No. 55251

---

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,
Plaintiff and Respondent,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
Defendant and Appellant,

---

(Filed February 11, 1980)

---

## NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that The Western and Southern Life Insurance Company, Plaintiff and Respondent above named, hereby appeals to the Supreme Court of the United States from the judgment of the Court of Appeal, Second Appellate District, State of California, filed November 2, 1979, as modified November 28, 1979, petition for hearing of which was filed December 11, 1979 with and denied December 27, 1979 by the Supreme Court of California. The judgment appealed from reversed the decision of the

Los Angeles Superior Court, Civil No. C 3189, holding that Plaintiff was entitled to refund of California taxes for the years 1966 through 1971 paid by it under protest.

This appeal is taken pursuant to 28 U.S.C. § 1257 (2).

/s/ ALAN R. VOGELER
FROST & JACOBS
2500 Central Trust Center
201 E. Fifth Street
Cincinnati, OH 45202
Attorneys for Plaintiff and
Respondent

**CERTIFICATE OF SERVICE**

STATE OF OHIO, COUNTY OF HAMILTON: SS:

I, the undersigned, Alan R. Vogeler, am a member of the bar of the Supreme Court of the United States and am counsel for The Western and Southern Life Insurance Company, Plaintiff and Respondent below, in behalf of whom service of this Notice is being effected.

On February 5, 1980, I served the foregoing document described as Notice of Appeal to the Supreme Court of the United States on all parties required to be served in this action by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid in the United States mail at Cincinnati, Ohio, addressed as follows:

SEE ATTACHED LIST.

/s/ ALAN R. VOGELER

George Deukmejian, Esq.
Ernest P. Goodman, Esq.
Timothy G. Laddish, Esq.
6000 State Building
San Francisco, CA 94102

The Honorable Alexander R. Early, III
Superior Court of the State of California
For the County of Los Angeles
111 North Hill Street
Los Angeles, CA 90012

Court of Appeal, State of California
Second Appellate District
Division Four
3580 Wilshire Boulevard, Room 301
Los Angeles, CA 90010

Supreme Court, State of California
4250 State Building
San Francisco, CA 94102

*Appendix B*

[UNDER LETTERHEAD, OFFICE OF THE CLERK
SUPREME COURT OF CALIFORNIA]

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February 8, 1980

Alan R. Vogeler, Esq.
Frost & Jacobs
2500 Central Trust Center
201 East Fifth Street
Cincinnati, Ohio 45202

Re: 2 Civ. 55251 — Western and Southern Life Insurance Company v. State Board of Equalization

Dear Mr. Vogeler:

The Notice of Appeal is returned for the reason that it appears you have properly filed same in the Court of Appeal, the court possessed with the record.

Very truly yours,

/s/ J. L. KAVANAGH
Chief Deputy

JLK:ms
Enclosure
cc: Attorney General

# APPENDIX C

**California Constitution, § 14-4/5(e):**

Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this State. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

Where as a result of merger, consolidation, or other method of acquisition of substantially all of the assets of one or more insurers by another insurer, effected prior to January 1, 1939, an insurer owns more than one parcel of real property in this State in which was located a home office or principal office of an insurer immediately prior to such acquisition, the owner shall designate one of such properties as its home or principal office. Real estate taxes paid by it in any of the years 1943 to 1952, inclusive, before, or within 30 days after, becoming delinquent, on such property owned by it at the time of payment and not so designated may also be deducted from the annual tax imposed by this section in respect to such year and are included within the deduction provided for in this subdivision.

**California Constitution, § 14-4/5(f):**

The tax imposed on insurers by this section is in lieu of

all other taxes and licenses, state, county, and municipal, upon such insurers and their property, except:

(1) Taxes upon their real estate.

(2) That an insurer transacting title insurance in this State which has a trust department or does a trust business under the banking laws of this State is subject to taxation with respect to such trust department or trust business to the same extent and in the same manner as trust companies and the trust departments of banks doing business in this State.

(3) When by the laws of any other state or country any taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations or prohibitions are imposed on insurers of this State doing business in such other state or country, or upon their agents therein, in excess of those imposed upon insurers of such other state or country or upon their agents therein, so long as such laws continue in force, the same obligations and prohibitions of whatsoever kind may be imposed by the Legislature upon insurers of such other state or country doing business in this State, or upon their agents herein.

(4) The tax on ocean marine insurance.

(5) Motor vehicle and other vehicle registration license fees and any other tax or license fee imposed by the State upon vehicles, motor vehicles or the operation thereof.

**California Insurance Code, § 685:**

**Imposition of retaliatory taxes, licenses, fees, fines, penalties or deposit requirements.**

When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or

other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this State, so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this article. (Added by Stats. 1959, c. 2120, p. 4945, § 1.)

**California Revenue and Taxation Code, § 12241:**

**Real estate taxes on principal office realty**

(a) Each insurer shall have the right to deduct from the tax imposed by this chapter upon an insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home

office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

(b) In the event a portion of the real property described in subdivision (a) is occupied by a person or persons other than the insurer the deduction granted the insurer by said subdivision shall be limited to that percentage not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this section, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(c) The phrase "person or persons other than the insurer" as used in subdivision (b) of this section shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the

corporate or other manager of the insurer to the extent of its insurance management activities.

(Added by Stats, 1961, c. 740, p. 1983, § 28, operative Jan. 1, 1962. Amended by Stats, 1967, c. 1007, p. 2600, § 4.)

**California Revenue and Taxation Code, § 12284:**

**Assessment; notice.**

Annually, on or before September 15th, the board shall assess in respect to the preceding calendar year, the retaliatory taxes imposed upon insurers, giving consideration to the recommendations of the Insurance Commissioner. Immediately after making the assessment of retaliatory tax against an insurer, the board shall give notice of the assessment to the insurer at its address as it appears in the records of the board. The board shall transmit copies of the notice to the Insurance Commissioner and the Controller.

(Added by Stats. 1961, c. 44, p. 985, § 1, eff. March 31, 1961.)

**California Revenue and Taxation Code, § 13102:**

**Necessity of claim for refund or credit.**

No suit or proceeding shall be maintained in any court for the recovery of any amount alleged to have been erroneously or illegally assessed or collected unless a claim for refund or credit has been duly filed in accordance with Article 2 of Chapter 7 of this part.[1]

(Added by Stats. 1961, c. 740, p. 1992, § 70, operative Jan. 1, 1962.)

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[1] Section 12977 et seq.

*Appendix C*

**California Revenue and Taxation Code, § 13103:**

**Action against board after notice of board's action on claim for refund or credit.**

Within 90 days after the mailing of the notice of the board's action upon a claim for refund or credit, the claimant may bring an action against the board on the grounds set forth in the claim in a court of competent jurisdiction in any county or city and county in the State in which the Attorney General has an office for the recovery of the whole or any part of the amount with respect to which the claim has been disallowed. The Attorney General shall defend the action.

(Added by Stats. 1961, c. 740, p. 1992, § 72, operative Jan. 1, 1962.)

No. 79-1423

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,
APPELLANT,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
APPELLEE.

Appeal From The Court Of Appeal,
Second Appellate District,
State of California

## JOINT APPENDIX


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Counsel for Appellee



Appeal Docketed March 13, 1980
Probable Jurisdiction Noted October 6, 1980.

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## CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

May 17, 1971 — Plaintiff's Complaint for Recovery of Taxes Paid Under Protest filed in Superior Court of the State of California for the County of Los Angeles.

June 4, 1971 — Defendant's Answer filed.

Dec. 31, 1976 — Stipulation of Facts filed.

Dec. 31, 1976 — Plaintiff's Amended Complaint for Recovery of Taxes Paid Under Protest filed.

Dec. 31, 1976 — Stipulation Re: Filing of Amended Complaint and Answer Thereto filed.

Dec. 31, 1976 — Notice of Motion and Motion to Specially Set Case for Trial and for Assignment of Case to Trial Judge for All Purposes; Declaration of Ronald M. Oster and Memorandum of Points and Authorities in Support Thereof.

Jan. 13, 1977 — Order entered assigning action to Judge Early.

Jan. 13, 1977 — Minute Order of Jan. 13, 1977, Setting Briefing Schedule and Trial Date entered.

Feb. 28, 1977 — Plaintiff's Opening Brief filed.

May 4, 1977 — Defendant's Trial Brief filed.

May 24, 1977 — Plaintiff's Reply Brief filed.

May 24, 1977 — Supplemental Stipulation filed.

June 10, 1977 — Defendant's Supplemental Trial Memorandum filed.

June 10, 1977 — Trial and Oral Argument.

June 10, 1977 — Minute Order of June 10, 1977 entered.

July 6, 1977 – Plaintiff's Reply Brief to Defendant's Supplemental Trial Memorandum filed.

August 4, 1977 – Minute Order of August 4, 1977 entered.

August 4, 1977 – Memorandum of Intended Decision filed.

Oct. 27, 1977 – Conclusions of Law filed.

Oct. 27, 1977 – Judgment entered in favor of Plaintiff.

Nov. 1, 1977 – Notice of Entry of Judgment.

Dec. 21, 1977 – Defendant's Notice of Appeal filed; Notice to Clerk of Superior Court to Prepare Reporter's Transcript on Appeal.

Nov. 2, 1979 – Opinion and Judgment of the Court of Appeal, Second Appellate District, State of California, reversing the decision of the lower court, entered.

Nov. 19, 1979 – Petition for Rehearing filed.

Nov. 28, 1979 – Order of the Court of Appeal, Second Appellate District, State of California, modifying its opinion of Nov. 2, 1979 and Denying Rehearing entered.

Dec. 11, 1979 – Petition for Hearing by the Supreme Court of California filed.

Dec. 27, 1979 – Order of the Supreme Court of California Denying the Petition for Hearing entered.

SUPERIOR COURT OF THE
STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

---

NO. C 3189

---

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, a corporation,

Plaintiff,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Defendant.

---

## STIPULATION OF FACTS

(Filed December 31, 1976)

IT IS HEREBY STIPULATED AND AGREED by and between the parties hereto, through their respective attorneys of record, for purposes of this case only, that the following facts shall be taken as true and shall be adopted as part of the Court's findings of fact. This stipulation shall not be construed as a concession by either party of the relevancy or materiality of any of the facts stipulated herein; and the parties hereto expressly reserve the right to argue the relevancy or materiality of any of the facts herein stipulated to be true.

Except as otherwise provided herein, all exhibits attached hereto, or otherwise incorporated herein by reference, are included for the limited purpose of showing the contents

thereof and not for the truth of the matters therein set forth; provided, however, that either party may offer any of such documents for additional purposes subject to objections as to competency, relevancy and materiality but not subject to the best evidence objection or any objection as to their genuineness or the due execution thereof.

Nothing herein contained shall be construed as a waiver by any of the parties hereto of their rights to review on appeal any question of law or of fact arising in this action in the same manner and to the same extent as if the facts herein set forth had been proven in open court.

Each party may introduce at the trial of this cause any other or further evidence which is not inconsistent with the facts stated herein. To the extent possible, notice of such intended introduction shall be given to the other party sufficiently in advance of trial to enable the other party to meet such evidence.

This stipulation shall be valid only in the above-entitled action.

1. Plaintiff is, and was continuously for more than eighteen (18) years last past and at all times herein referred to, a mutual life and disability insurer incorporated under the laws of, and having its principal place of business in, the State of Ohio and admitted and authorized to do and doing a life and disability insurance business and no other business in the State of California. Plaintiff did not at any time herein referred to, and does not now, have any surplus divided into shares, or any shares whatsoever. Plaintiff, effective July 1, 1956 and at all times thereafter, was, and now is, the holder of a Certificate of Authority for an indefinite term issued pursuant to the provisions of section 701 of the Insurance Code of the State of California. A copy of said Certificate of Authority

is attached hereto as Exhibit A and by reference is made a part hereof.

2. On December 4, 1962, in an action before the Superior Court of the State of California for the County of Los Angeles numbered 765737, in which action plaintiff herein was the plaintiff and the defendant herein and F. Britton McConnell, as Insurance Commissioner of the State of California, were the defendants, which action involved taxes for business done only in the year 1959, a judgment was duly entered against the defendants, and on said date, in an action before the Superior Court of the State of California for the County of Los Angeles numbered 785827, in which action plaintiff herein was the plaintiff and defendant herein was the defendant, which action involved taxes for business done only in the year 1960, a judgment was duly entered against the defendant. Each said judgment has become final. By each said judgment it was adjudicated, that by the laws of the State of Ohio, taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations or prohibitions imposed upon life insurers of California analogous to plaintiff doing business in Ohio, or upon their agents therein, were not in excess of those imposed by the State of Ohio upon such insurers of Ohio or upon their agents therein. Retaliatory taxes against plaintiff were not authorized under then existing California law and were not and could not be validly or legally assessed or collected as against plaintiff under then existing California law.

3. In the year 1965 and continuously thereafter, plaintiff's Principal Office in the State of California was, and now is, located at 2600 Wilshire Boulevard, Los Angeles, California, in real property then and now owned by plaintiff on which plaintiff had specially constructed a building for such purpose and on which it paid, before delinquency,

in the year 1965 and in all years thereafter, while its Principal Office was so located, the real estate taxes thereon duly assessed. Said real property at all times consisted only of one building in which such office was located, the land on which said building then stood and so much of the adjacent land as was then required for the convenient use and occupation thereof. Said real estate tax so paid for the years 1965 through 1971 was equal to the following sums:

1965 — $111,877.50
1966 — $115,644.37
1967 — $117,396.19
1968 — $124,069.03
1969 — $128,049.78
1970 — $121,173.59
1971 — $120,354.69

4. For each year, 1965, 1966, 1967, 1968, 1969, 1970 and 1971, and within the time provided by law, plaintiff filed with the Insurance Commissioner of the State of California, hereinafter referred to as "the Commissioner," in duplicate, its tax return (other than retaliatory) with respect to the business done by the plaintiff in California for the whole of each such calendar year, and as a part thereof, on a form supplied by the Department of Insurance, filed its Supplement to Annual Tax Return for each such year setting forth all information requested by the Department of Insurance relating to its Principal Office Tax Deduction. A copy of each said tax return, including the supplement, for each such year is attached hereto, marked "Exhibits B, C, D, E, F, G and H" respectively, and by reference said tax returns and supplements are made a part hereof.

5. (a) The California premiums tax return of plain-

tiff, including said supplement, for the year 1965 set forth that $133,595.10 was the gross premiums tax (exclusive of any retaliatory tax) payable by plaintiff on its business in California in the calendar year 1965; that the Principal Office Deduction allowable to plaintiff as a credit against the gross premiums tax for said year was $111,877.50, leaving a net premiums tax of $21,717.60 attributable to plaintiff's 1965 business in California, exclusive of any retaliatory tax; that plaintiff had, in conformity with the law, made prepayments on account of said tax in the aggregate sum of $12,000.00, leaving a balance of $9,717.60, which was duly and timely paid by plaintiff at the time it filed its said return. In addition plaintiff paid the Commissioner $35.00 as the fees claimed by the Commissioner for the filing of plaintiff's Annual Statement and on account of its Certificate of Authority.

(b) For purposes of this litigation the parties agree that the factual allegations, figures, and computations shown on plaintiff's 1965 premiums tax return and supplement thereto are accurate except that $5,893.94 of the deductions which were claimed by plaintiff on the return were later determined by defendant Board to be not properly deductible (see paragraph 5 (j) below).

(c) Plaintiff, after receiving written demand therefor from the Commissioner which threatened the imposition of mandatory penalties for any late filing thereof, filed, under protest, with the Commissioner, on or before September 1, 1966, a Retaliatory Tax Information Return with respect to the business done by plaintiff in California during the year 1965. A copy thereof is attached hereto as "Exhibit I" and by reference is made a part hereof.

(d) Defendant Board, on or about September 14, 1966, assessed and levied against plaintiff retaliatory tax in the

amount of $128,352.23, and on or about September 15, 1966, defendant gave written notice to plaintiff that, on the recommendation of the Commissioner, such assessment had been made as retaliatory tax pursuant to section 12284 of the Revenue and Taxation Code of California on plaintiff's business done in California in 1965, and that plaintiff would become subject to penalty in the event such additional tax was not paid by December 1, 1966. The Commissioner and the defendant Board computed such assessment of retaliatory taxes by subtracting plaintiff's California premiums tax liability of $21,717.60 (as computed by plaintiff on its return for the year 1965) and the California fees of $35.00 set forth in paragraph 5 (a) above from $150,104.83, the sum of the Ohio premiums taxes and fees which would have been imposed on a similar California insurer transacting the same kind and amount of insurance business in the State of Ohio that plaintiff transacted in California. Such amount of Ohio premiums taxes and fees was computed by the Commissioner and defendant Board from the figures reported by plaintiff on page 2 of plaintiff's 1965 Retaliatory Tax Information Return ("Exhibit I", included herein by reference in paragraph 5 (c) above) and it does not include any real estate taxes which would have been payable to the State of Ohio or any subdivision of the State of Ohio. The parties agree that the figures reported on "Exhibit I" are factually accurate.

(e) On or about October 7, 1966, plaintiff duly filed with defendant plaintiff's written petition for the correction of said retaliatory tax assessment on 1965 business, seeking the correction thereof to zero and the cancellation thereof. On October 13, 1966, an executed duplicate copy of said petition was filed with the Commissioner.

(f) The defendant Board denied plaintiff's petition and so notified plaintiff on November 23, 1966.

(g) On or about November 25, 1966, in response to the demand of the defendant therefor and under the threat of penalty for nonpayment thereof, plaintiff paid to the State Controller the full amount of said additional assessment with respect to 1965 business, $128,352.23, under written protest set forth in plaintiff's letter of transmittal of payment.

(h) On or about January 24, 1967, plaintiff duly filed with the defendant a duly executed Claim for Credit and Refund of Tax with respect to business done in 1965, demanding reimbursement of the amount of the additional tax payment made pursuant to demand of the defendant, $128,352.23, together with interest thereon. On or about said date, an executed duplicate copy of said claim was filed with the Commissioner. A copy of such claim is attached hereto, marked "Exhibit J" and incorporated herein by this reference as if fully rewritten herein.

(i) On or about February 18, 1971, said Claim for Credit and Refund was denied in its entirety by defendant Board, and written notice of defendant's denial of plaintiff's claim was mailed to plaintiff on or about February 22, 1971.

(j) Based on figures reported by plaintiff in 1970 in an amendment to its annual premiums tax return for year 1965, on or about June 12, 1970, defendant Board, acting pursuant to section 12424 of the Revenue and Taxation Code, assessed against plaintiff a premiums tax deficiency assessment of $137.33 plus interest; this assessment arose from the deduction on plaintiff's original return for 1965 of $5,893.94 later found to be not properly deductible. As a result of this assessment, the total 1965 premiums tax

liability for plaintiff as computed by defendant Board was increased to $21,854.93, and the total 1965 retaliatory tax liability for plaintiff as computed by defendant Board was reduced to $128,214.90. Plaintiff paid without protest the applicable interest of $4.12 and did not contest the addition of $137.33 to its 1965 premiums tax liability and the subtraction of the same amount from its 1965 retaliatory tax liability. This premiums tax assessment of $137.33 is not being challenged by plaintiff in this proceeding

(k) Of the $150,069.83 set forth above as taxes paid by plaintiff for the year 1965, defendant Board presently contends that $21,854.93 was due for 1965 premiums tax liability and $128,214.90 was due for 1965 retaliatory tax liability. Plaintiff agrees for purposes of this litigation that $21,854.93 was due from it as 1965 premiums tax liability, but contends that no retaliatory tax for 1965 was due.

6. (a) In its California premiums tax return and the supplement thereto for the year 1966 ("Exhibit C" included herein by reference in paragraph 4 above) plaintiff claimed that $146,765.33 was the gross premiums tax (exclusive of any retaliatory tax) payable by plaintiff due to its insurance business in California in the calendar year 1966. The amount of such tax was computed by plaintiff on the basis that the tax owed by plaintiff (an Ohio corporation) was the same tax as would be payable to California if plaintiff were an insurance company incorporated in California with otherwise identical attributes (which method of computation is hereinafter called the "California Company Basis"). The return and supplement thereto claimed that the Principal Office Deduction allowable to plaintiff for said year was $115,644.37, leaving a net premiums tax of $31,120.96 claimed by plaintiff

on the return as attributable to plaintiff's 1966 business in California, exclusive of any retaliatory tax. In addition to the calculation of the Principal Office Deduction on the "California Company Basis", plaintiff's return supplement also contained an alternative calculation of the Principal Office Deduction in which plaintiff attempted to calculate said deduction in the manner prescribed by Article XIII, Section 14 4/5,[1] subdivision (e) of the California Constitution as amended in 1966 and as applied to an Ohio corporation. By using such alternative calculation, the amount of the Principal Office Deduction was determined by plaintiff to be $37,538.56. Plaintiff, claiming that said 1966 amendment to the California Constitution was unconstittuional as applied to plaintiff, did not use the alternative calculation in arriving at the amount of premiums taxes it claimed on its return to be due for the year 1966. Plaintiff's return correctly recited that plaintiff had made prepayments on account of said tax in the aggregate sum of $21,000.00, leaving a balance due, as calculated by plaintiff, of $10,120.96, which amount was timely paid by plaintiff at the time it filed its said return. In addition plaintiff paid the Commissioner $35.00 as the fees claimed by the Commissioner for the year 1966 for the filing of plaintiff's annual statement and on account of its certificate of authority.

(b) For purposes of this litigation the parties agree that the factual allegations, figures, and computations shown on plaintiffs' 1966 premiums tax return and supplement thereto are true and accurate except for the following:

(i) $19,475.54 of the deductions which were claimed by plaintiff on the return were later deter-

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[1] In 1974 Section 14 4/5 was renumbered Section 28; the earlier number is used in this stipulation.

mined by defendant Board to be not properly deductible (see paragraph 6 (l) below);

(ii) Defendant Board contends that the plaintiff's alternative figures for the Principal Office Deduction should have been used to determine the proper amount of the Principal Office Deduction after being adjusted to reflect the allocation of the real estate taxes attributable to the parking areas involved (see paragraphs 6 (c) and 6 (m) below).

(c) On or before July 14, 1967, defendant Board, acting under sections 12412 and 12413 of the Revenue and Taxation Code, notified plaintiff that the premiums tax (exclusive of retaliatory tax) due from plaintiff for 1966 was $109,226.77, computed by subtracting from a gross tax of $146,765.33 a Principal Office Deduction of $37,538.56, which last-mentioned amount is the amount of the Principal Office Deduction resulting from the alternative calculation shown on plaintiff's 1966 premiums tax return supplement as described in paragraph 6 (a) above. The defendant thereupon notified plaintiff further that plaintiff was required to pay the additional amount of $78,105.81 as premiums tax, with interest at the rate of six percent (6%) per annum, to wit, $390.53, on or before July 15, 1967, or be subject to penalty thereon.

(d) On July 14, 1967, in response to defendant's demand and to avoid the penalties which the Commissioner threatened to impose against plaintiff for nonpayment of said additional assessment for the year 1966, plaintiff paid to the Commissioner, under written protest, said additional tax of $78,105.81 and $390.53 interest, a total of $78,496.34.

(e) Plaintiff, after receiving written demand therefor from the Commissioner which threatened the imposition of

mandatory penalties for any late filing thereof, filed, under protest, with the Commissioner, on or before August 1, 1967, a Retaliatory Tax Information Return with respect to the business done by plaintiff in California during the year 1966. This return was reported on the basis of a California Principal Office Deduction of $115,644.37. A copy thereof is attached hereto as "Exhibit K" and by reference is made a part hereof.

(f) Defendant Board, on or about August 10, 1967, assessed and levied against plaintiff retaliatory tax in the amount of $52,971.68, and on or about August 11, 1967, defendant gave written notice to plaintiff that, on the recommendation of the Commissioner, such assessment had been made as retaliatory tax pursuant to section 12284 of the Revenue and Taxation Code of California on plaintiff's business done in California in 1966, and that plaintiff would become subject to penalty in the event such additional tax was not paid by December 1, 1967. The Commissioner and the defendant Board computed such assessment of retaliatory taxes by subtracting plaintiff's California premiums tax liability of $109,226.77 (as computed by Commissioner and defendant in the assessment set forth in paragraph 6 (c) above) and the California fees of $35.00 set forth in paragraph 6 (a) above from $162,-233.45, the sum of the Ohio premiums taxes and fees which would have been imposed on a similar California insurer transacting the same kind and amount of insurance business in the State of Ohio that plaintiff transacted in California. Such amount of Ohio premiums taxes and fees was computed by the Commissioner and defendant Board from the figures reported by plaintiff on page 2 of plaintiff's 1966 Retaliatory Tax Information Return ("Exhibit K" included herein by reference in paragraph 6 (e) above) and does not include any real estate taxes which would

have been payable to the State of Ohio or any subdivision of the State of Ohio. The parties agree that the figures reported on pages 2 and 3 of "Exhibit K" are factually accurate.

(g) On or about September 21, 1967, plaintiff duly filed with defendant plaintiff's written petition for the correction of said retaliatory tax assessment on 1966 business, seeking the correction thereof to zero and the cancellation thereof. On September 21, 1967, an executed duplicate copy of said petition was filed with the Commissioner.

(h) The defendant Board denied plaintiff's petition on November 8, 1967, and so notified plaintiff on November 10, 1967.

(i) On or about November 24, 1967, in response to the demand of the defendant therefor and under the threat of penalty for nonpayment thereof, plaintiff paid to the State Controller the full amount of said additional assessment with respect to 1966 business, $52,971.68, under written protest set forth in plaintiff's letter of transmittal of payment.

(j) On or about December 14, 1967, plaintiff duly filed with the defendant two duly executed written Claims for Credit and Refund of tax with respect to business done in 1966. One of such claims was filed with respect to the portion of the tax paid for the year 1966 which resulted from the denial to plaintiff of part of the Principal Office Deduction it had claimed in its return on the "California Company Basis"; the other claim was filed with respect to the portion of such tax designated as retaliatory tax. Copies of said claims are attached hereto and marked "Exhibits L and M" respectively, and the same are incorporated herein by this reference as if fully rewritten herein.

(k) On or about February 18, 1971, each of said claims for Credit and Refund was denied in its entirety by defendant Board, and written notice of said denials was mailed to plaintiff on or about February 22, 1971.

(l) Based on figures reported by plaintiff in 1971 in an amendment to its annual premiums tax return for year 1966 (see last page of "Exhibit G" included herein by reference in paragraph 4 above) on or about June 8, 1971, defendant Board, acting pursuant to section 12424 of the Revenue and Taxation Code, assessed against plaintiff a premiums tax deficiency assessment of $453.77 plus interest; this assessment arose from the deduction on plaintiff's original return for 1966 of $19,475.54 later found to be not properly deductible. As a result of this assessment, the total 1966 premiums tax liability for plaintiff as computed by defendant Board was increased to $109,-680.54, and the total 1966 retaliatory tax liability for plaintiff as computed by defendant Board was reduced to $52,-517.91. Plaintiff paid without protest the applicable interest of $13.61 and did not contest the addition of $453.77 to its 1966 premiums tax liability and the subtraction of the same amount from its 1966 retaliatory tax liability. This premiums tax assessment of $453.77 is not being challenged by plaintiff in this proceeding.

(m) On or about February 3, 1972, defendant Board, acting pursuant to section 12424 of the Revenue and Taxation Code, assessed against plaintiff a premiums tax deficiency assessment for year 1966 of $2,792.05 plus interest. Such assessment was made because, in making the alternative calculation regarding the Principal Office Deduction in its 1966 premiums tax return supplement as described in paragraph 6 (a) above, plaintiff had not apportioned the real estate taxes paid for parking areas pertaining to its principal office building between the areas

used by plaintiff and the areas used by plaintiff's tenants. The amount of the additional assessment was determined solely through the use of figures provided by plaintiff in its 1966 premiums tax return and supplement. As a result of this assessment, the total 1966 premiums tax liability for plaintiff as computed by defendant Board was increased to $112,472.59, and the total 1966 retaliatory tax liability for plaintiff as computed by defendant Board was reduced to $49,725.86. On March 6, 1972, the State Controller received from plaintiff payment of the interest charged by defendant; plaintiff denied and continues to deny the validity of any allocation of real estate taxes paid by plaintiff on the parking lots pertaining to its office building housing its principal California office.

(n) Of the $162,198.45 set forth above as taxes paid by plaintiff for the year 1966, defendant Board presently contends that $112,472.59 was due for 1966 premiums tax liability and $49,725.86 was due for 1966 retaliatory tax liability. Plaintiff contends for purposes of this litigation that $31,574.73 was due from it as 1966 premiums tax liability, and that no retaliatory tax for 1966 was due. The $80,897.86 difference between the 1966 premiums tax liability as computed by the Board and as computed by plaintiff is attributable solely to the questions of whether the 1966 amendment to article XIII, section 14 4/5, subdivision (e) is constitutional and whether it can be constitutionally applied to plaintiff.

7. (a) In its California premiums tax return and the supplement thereto for the year 1967 ("Exhibit D" included herein by reference in paragraph 4 above) plaintiff claimed that $162,323.81 was the gross premiums tax (exclusive of any retaliatory tax) payable by plaintiff due to its insurance business in California in the calendar year 1967. The amount of such tax was computed by plain-

tiff on the "California Company Basis" (as if plaintiff were a California corporation). The return and supplement thereto claimed that the Principal Office Deduction allowable to plaintiff for said year was $117,396.19, leaving a net premiums tax of $44,927.62 claimed by plaintiff on the return as attributable to plaintiff's 1967 business in California, exclusive of any retaliatory tax. In addition to the calculation of the Principal Office Deduction on the "California Company Basis", plaintiff's return supplement also contained an alternative calculation of the Principal Office Deduction in which plaintiff attempted to calculate said deduction in the manner prescribed by Article XIII, section 14 4/5, subdivision (e) of the California Constitution as amended in 1966 and as applied to an Ohio corporation. By using such alternative calculation, the amount of the Principal Office Deduction was determined by plaintiff to be $41,423.43. Plaintiff claiming that said 1966 amendment to the California Constitution was unconstitutional as applied to plaintiff, did not use the alternative calculation in arriving at the amount of premiums taxes it claimed on its return to be due for the year 1967. Plaintiff's return correctly recited that plaintiff had made prepayments on account of said tax in the aggregate sum of $48,000.00. Thus, according to plaintiff's calculation, the prepayments for the calendar year 1967 exceeded the amount of the premiums tax due for said year by $3,072.38. In addition plaintiff paid the Commissioner $72.50 as the fees claimed by the Commissioner for the year 1967 for the filing of plaintiff's annual statement, for the filing of certain amendment forms, and on account of its certificate of authority.

(b) For purposes of this litigation the parties agree that the factual allegations, figures, and computations shown on plaintiff's 1967 premiums tax return and sup-

plement thereto are true and accurate except that defendant Board contends that plaintiff's alternative figures for the Principal Office Deduction should have been used to determine the proper amount of the Principal Office Deduction after being adjusted to reflect the allocation of the real estate taxes attributable to the parking areas involved (see paragraphs 7 (c) and 7 (i) below).

(c) On or about May 9, 1968, defendant Board, acting under sections 12412 and 12413 of the Revenue and Taxation Code, notified plaintiff that the premiums tax (exclusive of retaliatory tax) due from plaintiff for 1967 was $120,900.38, computed by subtracting from a gross tax of $162,323.81 a Principal Office Deduction of $41,423.43, which last-mentioned amount is the amount of the Principal Office Deduction resulting from the alternative calculation shown on plaintiff's 1967 premiums tax return supplement as described in paragraph 7 (a) above. The defendant thereupon notified plaintiff further that plaintiff was required to pay the additional amount of $72,900.38 as premiums tax on or before June 15, 1968, or be subject to penalty and interest thereon.

(d) On June 10, 1968, in response to defendant's demand and to avoid the penalties which the Commissioner threatened to impose against plaintiff for non-payment of said additional assessment for the year 1967, plaintiff paid to the Commissioner, under written protest, said additional tax of $72,900.38.

(e) Plaintiff, after receiving written demand therefor from the Commissioner which threatened the imposition of mandatory penalties for any late filing thereof, filed, under protest, with the Commissioner, on or before August 15, 1968, a Retaliatory Tax Information Return with respect to the business done by plaintiff in California dur-

ing the year 1967. This return was reported on the basis of a California Principal Office Deduction of $117,396.19. A copy thereof is attached hereto as "Exhibit N" and by reference is made a part hereof.

(f) Defendant Board, on or about August 27, 1968, assessed and levied against plaintiff retaliatory tax in the amount of $60,270.01, and on or about August 28, 1968, defendant gave written notice to plaintiff that, on the recommendation of the Commissioner, such assessment had been made a retaliatory tax pursuant to section 12284 of the Revenue and Taxation Code of California on plaintiff's business done in California in 1967, and that plaintiff would become subject to penalty in the event such additional tax was not paid by December 1, 1968. The Commissioner and the defendant Board computed such assessment of retaliatory taxes by subtracting plaintiff's California premiums tax liability of $120,900.38 (as computed by Commissioner and defendant in the assessment set forth in paragraph 7 (c) above) and the California fees of $72.50 set forth in paragraph 7 (a) above from $181,242.89, the sum of the Ohio premiums taxes and fees which would have been imposed on a similar California insurer transacting the same kind and amount of insurance business in the State of Ohio that plaintiff transacted in California. Such amount of Ohio premiums taxes and fees was computed by the Commissioner and defendant Board from the figures reported by plaintiff on page 2 of plaintiff's 1967 Retaliatory Tax Information Return ("Exhibit N" included herein by reference in paragraph 7 (e) above) and does not include any real estate taxes which would have been payable to the State of Ohio or any subdivision of the State of Ohio. The parties agree that the figures reported on pages 2 and 3 of "Exhibit N" to the Amended Complaint are factually accurate.

(g) On or about September 20, 1968, plaintiff duly filed with defendant plaintiff's written petition for the correction of said retaliatory tax assessment on 1967 business, seeking the correction thereof to zero and the cancellation thereof. On or about September 20, 1968, an executed duplicate copy of said petition was filed with the Commissioner.

(h) The defendant Board denied plaintiff's petition and so notified plaintiff on November 20, 1968.

(i) On or about November 29, 1968, in response to the demand of the defendant therefor and under the threat of penalty for nonpayment thereof, plaintiff paid to the State Controller the full amount of said additional assessment with respect to 1967 business, $60,270.01, under written protest set forth in plaintiff's letter of transmittal of payment.

(j) On or about December 2, 1968, plaintiff duly filed with the defendant two duly executed written Claims for Credit and Refund of tax with respect to business done in 1967. One of such claims was filed with respect to the portion of the tax paid for the year 1967 which resulted from the denial to plaintiff of part of the Principal Office Deduction it had claimed in its return on the "California Company Basis"; the other claim was filed with respect to the portion of such tax designated as retaliatory tax. Copies of said claims are attached hereto and marked "Exhibits O and P" respectively, and the same are incorporated herein by this reference as if fully written herein.

(k) On or about February 18, 1971, each of said Claims for Credit and Refund was denied in its entirety by defendant Board, and written notice of said denials was mailed to plaintiff on or about February 22, 1971.

(l) On or about February 3, 1972, defendant Board, acting pursuant to section 12424 of the Revenue and Taxation Code, assessed against plaintiff a premiums tax deficiency assessment for year 1967 of $2,180.21 plus interest. Such assessment was made because in making the alternative calculation regarding the Principal Office Deduction in its 1967 premiums tax return supplement as described in paragraph 7 (a) above, plaintiff had not apportioned the real estate taxes paid for parking areas pertaining to its principal office building between the areas used by plaintiff and the areas used by plaintiff's tenants. The amount of the additional assessment was determined solely through the use of figures provided by plaintiff in its 1967 premiums tax return and supplement. As a result of this assessment, the total 1967 premiums tax liability for plaintiff as computed by defendant Board was increased to $123,080.59, and the total 1967 retaliatory tax liability for plaintiff as computed by defendant Board was reduced to $58,089.80. On March 6, 1972, the State Controller received from plaintiff payment of applicable interest charged by defendant; plaintiff denied and continues to deny the validity of any allocation of real estate taxes paid by plaintiff on the parking lots pertaining to its office building housing its principal California office.

(m) Of the $181,170.39 set forth above as taxes paid by plaintiff for the year 1967, defendant Board presently contends that $123,080.59 was due for 1967 premiums tax liability and $58,089.80 was due for 1967 retaliatory tax liability. Plaintiff contends for purposes of this litigation that $44,927.62 was due from it as 1967 premiums tax liability, and that no retaliatory tax for 1967 was due. The $78,152.97 difference between the 1967 premiums tax liability as computed by the Board and as computed by plaintiff is attributable solely to the questions of whether the

1966 amendment to article XIII, section 14 4/5, subdivision (e) is constitutional and whether it can be constitutionally applied to plaintiff.

8. (a) In its California premiums tax return and the supplement thereto for the year 1968 ("Exhibit E" included herein by reference in paragraph 4 above) plaintiff claimed that $179,568.24 was the gross premiums tax (exclusive of any retaliatory tax) payable by plaintiff due to its insurance business in California in the calendar year 1968. The amount of such tax was computed by plaintiff on the "California Company Basis" (as if plaintiff were a California corporation). The return and supplement thereto claimed that the Principal Office Deduction allowable to plaintiff for said year was $124,069.03, leaving a net premiums tax of $55,499.21 claimed by plaintiff on the return as attributable to plaintiff's 1968 business in California, exclusive of any retaliatory tax. In addition to calculation of the Principal Office Deduction on the "California Company Basis", plaintiff's return supplement also contained an alternative calculation of the Principal Office Deduction in which plaintiff attempted to calculate said deduction in the manner prescribed by article XIII, section 14 4/5, subdivision (e) of the California Constitution as amended in 1966 and as applied to an Ohio corporation. By using such alternative calculation, the amout of the Principal Office Deduction was determined by plaintiff to be $43,757.46. Plaintiff, claiming that said 1966 amendment to the California Constitution was unconstitutional, as applied to plaintiff, did not use the alternative calculation in arriving at the amount of premiums taxes it claimed on its return to be due for the year 1968. Plaintiff's return correctly recited that plaintiff had made prepayments on account of said tax in the aggregate sum of $52,000.00, leaving a balance due, as calculated by plaintiff, of $3,-

499.21, which amount was timely paid by plaintiff at the time it filed its said return. In addition plaintiff paid the Commissioner $322.50 as the fees claimed by the Commissioner for the year 1968 for the filing of plaintiff's annual statement, for approval and policy filing, and on account of its certificate of authority.

(b) For purposes of this litigation the parties agree that the factual allegations, figures, and computations shown on plaintiff's 1968 premiums tax return and supplement thereto are true and accurate except that defendant Board contends that the plaintiff's alternative figures for the Principal Office Deduction should have been used to determine the proper amount of the Principal Office Deduction after being adjusted to reflect the allocation of the real estate taxes attributable to the parking areas involved (see paragraph 8 (c) and 8 (l) below).

(c) On or about October 2, 1969, defendant Board, acting under sections 12412 and 12413 of the Revenue and Taxation Code, notified plaintiff that the premiums tax (exclusive of retaliatory tax) due from plaintiff for 1968 was $135,810.78, computed by subtracting from a gross tax of $179,568.24 a Principal Office Deduction of $43,-757.46, which last-mentioned amount is the amount of the Principal Office Deduction resulting from the alternative calculation shown on plaintiff's 1968 premiums tax return supplement as described in paragraph 8 (a) above. The defendant thereupon notified plaintiff further that plaintiff was required to pay the additional amount of $80,-311.57 as premiums tax, with interest at the rate of six per cent (6%) per anum, to wit, $1,606.23, on or before November 1, 1969, or be subject to penalty thereon.

(d) On October 13, 1969, in response to defendant's demand and to avoid the penalties which the Commissioner

threatened to impose against plaintiff for nonpayment of said additional assessment for the year 1968, plaintiff paid to the Commissioner, under written protest, said additional tax of $80,311.57 and $1,606.23 interest, a total of $31,917.80.

(e) Plaintiff, after receiving written demand therefor from the Commissioner which threatened the imposition of mandatory penalties for any late filing thereof, filed, under protest, with the Commissioner, on or before August 20, 1969, a Retaliatory Tax Information Return with respect to the business done by plaintiff in California during the year 1968. This return was reported on the basis of a California Principal Office Deduction of $124,069.03. A copy thereof is attached hereto as "Exhibit Q" and by reference is made a part hereof.

(f) Defendant Board, on or about September 2, 1969, assessed and levied against plaintiff retaliatory tax in the amount of $65,390.47, and on or about September 3, 1969, defendant gave written notice to plaintiff that, on the recommendation of the Commissioner, such assessment had been made as retaliatory tax pursuant to section 12284 of the Revenue and Taxation Code of California on plaintiff's business done in California in 1968, and that plaintiff would become subject to penalty in the event such additional tax was not paid by December 1, 1969. The Commissioner and the defendant Board computed such assessment of retaliatory taxes by subtracting plaintiff's California premiums tax liability of $135,810.78 (as computed by Commissioner and defendant in the assessment set forth in paragraph 8 (c) above) and the California fees of $322.50 set forth in paragraph 8 (a) above from $201,523.75, the sum of the Ohio premiums taxes and fees which would have been imposed on a similar California insurer transacting the same kind and amount of insurance business in

the State of Ohio that plaintiff transacted in California. Such amount of Ohio premiums taxes and fees was computed by the Commissioner and defendant Board from the figures reported by plaintiff on page 2 of plaintiff's 1968 Retaliatory Tax Information Return ("Exhibit Q" included herein by reference in paragraph 8 (e) above) and does not include any real estate taxes which would have been payable to the State of Ohio or any subdivision of the State of Ohio. Defendant Board and the Commissioner did not include in the Ohio burden of $1,065.00 in agents' license fees shown on said page 2 of "Exhibit Q". The parties agree that the figures reported on page 2 and 3 of "Exhibit Q" are factually accurate.

(g) On or about October 9, 1969, plaintiff duly filed with defendant plaintiff's written petition for the correction of said retaliatory tax assessment on 1968 business, seeking the correction thereof to zero and the cancellation thereof. On or about the same date an executed duplicate copy of said petition was filed with the Commissioner.

(h) The defendant Board denied plaintiff's petition and so notified plaintiff on November 6, 1969.

(i) On or about November 21, 1969, in response to the demand of the defendant therefor and under the threat of penalty for nonpayment thereof, plaintiff paid to the State Controller the full amount of said additional assessment with respect to 1968 business, $65,390.47, under written protest set forth in plaintiff's letter of transmittal of payment.

(j) On or about November 21, 1969, plaintiff duly filed with the defendant two duly executed written Claims for Credit and Refund of tax with respect to business done in 1968. One of such claims was filed with respect to the portion of the tax paid for the year 1968 which resulted

from the denial to plaintiff of part of the Principal Office Deduction it had claimed in its return on the "California Company Basis"; the other claim was filed with respect to the portion of such tax designated as retaliatory tax. Copies of said claims are attached hereto and marked "Exhibits R and S" respectively, and the same are incorporated herein by this reference as if fully rewritten herein.

(k) On or about February 18, 1971, each of said Claims for Credit and Refund was denied in its entirety by defendant Board, and written notice of said denials was mailed to plaintiff.

(l) On or about February 3, 1972, defendant Board, acting pursuant to section 12424 of the Revenue and Taxation Code, assessed against plaintiff a premiums tax deficiency assessment for year 1968 of $2,304.72 plus interest. Such assessment was made because in making the alternative calculation regarding the Principal Office Deduction in its 1968 premium tax return supplement as described in paragraph 8(a) above, plaintiff had not apportioned the real estate taxes paid for parking areas pertaining to its principal office building between the areas used by plaintiff and the areas used by plaintiff's tenants. The amount of the additional assessment was determined solely through the use of figures provided by plaintiff in its 1968 premiums tax return and supplement. As a result of this assessment, the total 1968 premiums tax liability for plaintiff as computed by defendant Board was increased to $138,115.50, and the total 1968 retaliatory tax liability for plaintiff as computed by defendant Board was reduced to $63,085.75. On March 6, 1972, defendant received from plaintiff payment of applicable interest charged by defendant; plaintiff denied and continues to deny the validity of any allocation of real estate taxes paid by plaintiff on the parking lots pertaining to its office building housing its principal California office.

(m) Of the $201,201.25 set forth above as taxes paid by plaintiff for the year 1968, defendant Board presently contends that $138,115.50 was due for 1968 premiums tax liability and $63,085.75 was due for 1968 retaliatory tax liability. Plaintiff contends for purposes of this litigation that $55,499.21 was due from it as 1968 premiums tax liability, and that no retaliatory tax for 1968 was due. The $82,616.29 difference between the 1968 premiums tax liability as computed by the Board and as computed by plaintiff is attributable solely to the questions of whether the 1966 amendment to article XIII, section 14 4/5, subdivision (e) is constitutional and whether it can be constitutionally applied to plaintiff.

9. (a) In its California premiums tax return and the supplement thereto for the year 1969 ("Exhibit F" included herein by reference in paragraph 4 above) plaintiff claimed that $188,241.91 was the gross premiums tax (exclusive of any retaliatory tax) payable by plaintiff due to its insurance business in California in the calendar year 1969. The amount of such tax was computed by plaintiff on the "California Company Basis" (as if plaintiff were a California corporation). The return and supplement thereto claimed that the Principal Office Deduction allowable to plaintiff for said year was $128,049.78, leaving a net premiums tax of $60,192.13 claimed by plaintiff on the return as attributable to plaintiff's 1969 business in California, exclusive of any retaliatory tax. In addition to calculation of the Principal Office Deduction on the "California Company Basis", plaintiff's return supplement also contained an alternative calculation of the Principal Office Deduction in which plaintiff attempted to calculate said deduction in the manner prescribed by Article XIII, section 14 4/5, subdivision (e) of the California Constitution as amended in 1966 and as applied to an Ohio corporation.

By using such alternative calculation, the amount of the Principal Office Deduction was determined by plaintiff to be $46,473.23. Plaintiff, claiming that said 1966 amendment to the California Constitution was unconstitutional as applied to plaintiff, did not use the alternative calculation in arriving at the amount of premiums taxes it claimed on its return to be due for the year 1969. Plaintiff's return correctly recited that plaintiff had made prepayments on account of said tax in the aggregate sum of $45,000.00, leaving a balance due, as calculated by plaintiff, of $15,192.13, which amount was timely paid by plaintiff at the time it filed its said return. In addition plaintiff paid the Commissioner $175.00 as the fees claimed by the Commissioner for the year 1969 for the filing of plaintiff's annual statement, for approval and policy filing, and on account of its certificate of authority.

(b) For purposes of this litigation the parties agree that the factual allegations, figures, and computations shown on plaintiff's 1969 premiums tax return and supplement thereto are true and accurate except that defendant Board contends that the plaintiff's alternative figures for the Principal Office Deduction should have been used after being adjusted to reflect the allocation of the real estate taxes attributable to the parking areas involved (see paragraphs 9 (c) and 9 (k) below).

(c) At the time of the filing of its tax return for the year 1969, in addition to prepayments of $45,000.00 and the balance of $15,192.13 set forth by plaintiff as then due, plaintiff paid under protest $81,576.55 representing the additional amount of tax which would have been due if the Principal Office Deduction were computed as shown in the alternative calculation on plaintiff's return supplement. Plaintiff thus paid total premiums tax for 1969 (other than retaliatory tax) of $141,768.68, of which $81,576.55 was

paid under written protest and asserted to be illegally claimed and collected. Said amount of $81,576.55 was paid without awaiting an assessment by the defendant for said amount, in order to simplify the handling of plaintiff's claim for refund of said amount, for the defendant's convenience, and in accordance with plaintiff's letters of transmittal accompanying its tax payments.

(d) Plaintiff, after receiving written demand therefor from the Commissioner which threatened the imposition of mandatory penalties for any late filing thereof, filed, under protest, with the Commissioner, on or before August 7, 1970, a Retaliatory Tax Information Return with respect to the business done by plaintiff in California during the year 1969. This return was reported on the basis of a California Principal Office Deduction of $128,049.78. A copy thereof is attached hereto as "Exhibit T" and by reference is made a part hereof.

(e) Defendant Board, on or about August 18, 1970, assessed and levied against plaintiff retaliatory tax in the amount of $66,265.56, and on or about August 19, 1970, defendant gave written notice to plaintiff that, on the recommendation of the Commissioner, such assessment had been made as retaliatory tax pursuant to section 12284 of the Revenue and Taxation Code of California on plaintiff's business done in California in 1969, and that plaintiff would become subject to penalty in the event such additional tax was not paid by December 1, 1970. The Commissioner and the defendant Board computed such assessment of retaliatory taxes by subtracting plaintiff's California premiums tax liability of $141,768.68 (as computed by Commissioner and defendant using the alternative computation on plaintiff's premiums tax return supplement for 1970) and the California fees of $175.00 set forth in

paragraph 9 (a) above from $208,209.24, the sum of the Ohio premiums taxes and fees which would have been imposed on a similar California insurer transacting the same kind and amount of insurance business in the State of Ohio that plaintiff transacted in California. Such amount of Ohio premiums taxes and fees was computed by the Commissioner and defendant Board from the figures reported by plaintiff on page 2 of plaintiff's 1969 Retaliatory Tax Information Return ("Exhibit T" included herein by reference in paragraph 9 (d) above) and does not include any real estate taxes which would have been payable to the State of Ohio or any subdivision of the State of Ohio. The parties agree that the figures reported on pages 2 and 3 of "Exhibit T" are factually accurate.

(f) On or about September 18, 1970, plaintiff duly filed with defendant plaintiff's written petition for the correction of said retaliatory tax assessment on 1969 business, seeking the correction thereof to zero and the cancellation thereof. On the same date an executed duplicate copy of said petition was filed with the Commissioner.

(g) The defendant Board denied plaintiff's petition and so notified plaintiff on November 6, 1970.

(h) On or about November 30, 1970, in response to the demand of the defendant therefor and under the threat of penalty for nonpayment thereof, plaintiff paid to the State Controller the full amount of said additional assessment with respect to 1969 business, $66,265.56, under written protest set forth in plaintiff's letter of transmittal of payment.

(i) On or about February 22, 1971, plaintiff duly filed with the defendant two duly executed written Claims for Credit and Refund of tax with respect to business done in 1969. One of such claims was filed with respect to the

portion of the tax paid for the year 1969 which resulted from the denial to plaintiff of part of the Principal Office Deduction it had claimed in its return on the "California Company Basis"; the other claim was filed with respect to the portion of such tax designated as retaliatory tax. Copies of said claims are attached hereto and marked "Exhibits U and V" respectively, and the same are incorporated herein by this reference as if fully rewritten herein.

(j) On or about March 24, 1971, each of said Claims for Credit and Refund was denied in its entirety by defendant Board, and written notice of said denials was mailed to plaintiff on or about March 25, 1971.

(k) On or about February 3, 1972, defendant Board, acting pursuant to section 12424 of the Revenue and Taxation Code, assessed against plaintiff a premiums tax deficiency assessment for year 1969 of $2,477.91 plus interest. Such assessment was made because in making the alternative calculation regarding the Principal Office Deduction in its 1969 premiums tax return supplement as described in paragraph 9 (a) above, plaintiff had not apportioned the real estate taxes paid for parking areas pertaining to its principal office building between the areas used by plaintiff and the areas used by plaintiff's tenants. The amout of the additional assessment was determined solely through the use of figures provided by plaintiff in its 1969 premiums tax return and supplement. As a result of this assessment, the total 1969 premiums tax liability for plaintiff as computed by defendant Board was increased to $144,-246.59, and the total 1969 retaliatory tax liability for plaintiff as computed by defendant Board was reduced to $63,-787.65. On March 6, 1972, the State Controller received from plaintiff payment of applicable interest charged by defendant; plaintiff denied and continues to deny the validity of any allocation of real estate taxes paid by plain-

tiff on the parking lots pertaining to its office building housing its principal California office.

(l) Of the $208,034.24 set forth above as taxes paid by plaintiff for the year 1969, defendant Board presently contends that $144,246.59 was due for 1969 premiums tax liability and $63,787.65 was due for 1969 retaliatory tax liability. Plaintiff contends for purposes of this litigation that $60,192.13 was due from it as 1969 premiums tax liability, and that no retaliatory tax for 1969 was due. The $84,054.46 difference between the 1969 premiums tax liability as computed by the Board and as computed by plaintiff is attributable solely to the questions of whether the 1966 amendment to article XIII, section 14 4/5, subdivision (e) is constitutional and whether it can be constitutionally applied to plaintiff.

10. (a) In its California premiums tax return and the supplement thereto for the year 1970 ("Exhibit G" included herein by reference in paragraph 4 above) plaintiff claimed that $201,533.20 was the gross premiums tax (exclusive of any retaliatory tax) payable by plaintiff due to its insurance business in California in the calendar year 1970. The amount of such tax was computed by plaintiff on the "California Company Basis". The return and supplement thereto claimed that the Principal Office Deduction allowable to plaintiff for said year was $121,173.59, leaving a net premiums tax of $80,359.61 claimed by plaintiff on the return as attributable to plaintiff's 1970 business in California, exclusive of any retaliatory tax In addition to the calculation of the Principal Office Deduction on the "California Company Basis", plaintiff's return supplement also contained an alternative calculation of the Principal Office Deduction in which plaintiff attempted to calculate said deduction in the manner prescribed by Article XIII, section 14 4/5, subdivision (e) of the California Constitu-

tion as amended in 1966 and as applied to an Ohio corporation. By using such alternative calculation, the amount of the Principal Office Deduction was determined by plaintiff to be $44,727.04. Plaintiff, claiming that said 1966 amendment to the California Constitution was unconstitutional as applied to plaintiff, did not use the alternative calculation in arriving at the amount of premiums taxes claimed on its return to be due for the year 1970. Plaintiff's return correctly recited that plaintiff had made prepayments on account of said tax in the aggregate sum of $112,706.10. Thus, according to plaintiff's calculation the prepayments for the calendar year 1970 exceeded the amount of the premiums tax due for said year by $32,-346.49. In addition plaintiff paid the Commissioner $125.00 as the fees claimed by the Commissioner for the year 1970 for the filing of plaintiff's annual statement, and on account of its certificate of authority.

(b) For purposes of this litigation the parties agree that the factual allegations, figures, and computations shown on plaintiff's 1970 premiums tax return and supplement thereto are true and accurate except that defendant Board contends that the plaintiff's alternative figures for the Principal Office Deduction should have been used to determine the proper amount of the Principal Office Deduction after being adjusted to reflect the allocation of real estate taxes attributable to the parking areas involved (see paragraphs 10 (c) and 10 (k) below).

(c) At the time of the filing of its tax return for the year 1970, in addition to prepayments of $112,706.10, plaintiff paid under protest $44,100.06 representing the additional amount of tax which would have been due if the Principal Office Deduction were computed as shown in the alternative calculation on plaintiff's return supple-

ment. Plaintiff thus paid total gross premiums tax for 1970 (other than retaliatory tax) of $156,806.16, of which $76,446.55 was paid under written protest and asserted to be illegally claimed and collected. Said amount of $76,-446.55 was paid without awaiting an assessment by the defendant for said amount, in order to simplify the handling of plaintiff's claim for refund of said amount, for the defendant's convenience, and in accordance with plaintiff's letters of transmittal accompanying its tax payments.

(d) Plaintiff, after receiving written demand therefor from the Commissioner which threatened the imposition of mandatory penalties for any late filing thereof, filed, under protest, with the Commissioner, within the time fixed by law, a Retaliatory Tax Information Return with respect to the business done by plaintiff in California during the year 1970. This return was reported on the basis of a California Principal Office Deduction of $121,173.59. A copy thereof is attached hereto as "Exhibit W" and by reference is made a part hereof.

(e) Defendant Board, on or about August 18, 1971, assessed and levied against plaintiff retaliatory tax in the amount of $67,539.12, and on or about August 18, 1971, defendant gave written notice to plaintiff that, on the recommendation of the Commissioner, such assessment had been made as retaliatory tax pursuant to section 12284 of the Revenue and Taxation Code of California on plaintiff's business done in California in 1970, and that plaintiff would become subject to penalty in the event such additional tax was not paid by December 1, 1971. The Commissioner and the defendant Board computed such assessment of retaliatory taxes by subtracting plaintiff's California premiums tax liability of $156,806.16 (as computed by Commissioner and defendant using the alternative

computation on plaintiff's premiums tax return supplement for 1970) and the California fees of $125.00 set forth in paragraph 10 (a) above from $224,570.28, the sum of the Ohio premiums taxes and fees which would have been imposed on a similar California insurer transacting the same kind and amount of insurance business in the State of Ohio that plaintiff transacted in California. Such amount of Ohio premiums taxes and fees was computed by the Commissioner and defendant Board from the figures reported by plaintiff on page 2 of plaintiff's 1970 Retaliatory Tax Information Return ("Exhibit W" included herein by reference in paragraph 10 (d) above) and does not include any real estate taxes which would have been payable to the State of Ohio or any subdivision of the State of Ohio. The parties agree that the figures reported on pages 2 and 3 of "Exhibit W" are factually accurate.

(f) On or about August 25, 1971, plaintiff duly filed with defendant plaintiff's written petition for the correction of said retaliatory tax assessment on 1970 business, seeking the correction thereof to zero and the cancellation thereof. On the same date, an executed duplicate copy of said petition was filed with the Commissioner.

(g) The defendant Board denied plaintiff's petition on October 29, 1971 and so notified plaintiff on November 1, 1971.

(h) On or about November 23, 1971, in response to the demand of the defendant therefor and under the threat of penalty for nonpayment thereof, plaintiff paid to the State Controller the full amount of said additional assessment with respect to 1970 business, $67,639.12, under written protest set forth in plaintiff's letter of transmittal of payment.

(i) On or about March 8, 1972, plaintiff duly filed with

the defendant two duly executed written Claims for Credit and Refund of tax with respect to business done in 1970. One of such claims was filed with respect to the portion of the tax paid for the year 1970 which resulted from the denial to plaintiff of part of the Principal Office Deduction it had claimed in its return on the "California Company Basis"; the other claim was filed with respect to the portion of such tax designated as retaliatory tax. Copies of said claims are attached hereto and marked "Exhibits X and Y" respectively, and the same are incorporated herein by this reference as if fully rewritten herein.

(j) Neither of said Claims for Credit and Refund was acted upon by defendant Board before the filing of the Amended Complaint by plaintiff pursuant to section 13104 of the Revenue and Taxation Code.

(k) On or about February 3, 1972, defendant Board, acting pursuant to section 12424 of the Revenue and Taxation Code, assessed against plaintiff a premiums tax deficiency assessment for year 1970 of $2,711.30 plus interest. Such assessment was made because in making the alternative calculation regarding the Principal Office Deduction in its 1970 premiums tax return supplement as described in paragraph 10 (a) above, plaintiff had not apportioned the real estate taxes paid for parking areas pertaining to its principal office building between the areas used by plaintiff and the areas used by plaintiff's tenants. The amount of the additional assessment was determined solely through the use of figures provided by plaintiff in its 1970 premiums tax return and supplement. As a result of this assessment, the total 1970 premiums tax liability for plaintiff as computed by defendant Board was increased to $159,517.46, and the total 1970 retaliatory tax liability for plaintiff as computed by defendant Board was reduced to $64,927.82. On March 6, 1972, the State Con-

troller received from plaintiff payment of applicable interest charged by defendant; plaintiff denied and continues to deny the validity of any allocation of real estate taxes paid by plaintiff on the parking lots pertaining to its office building housing its principal California office.

(1) Of the $224,445.28 set forth above as taxes paid by plaintiff for the year 1970, defendant Board presently contends that $159,517.46 was due for 1970 premiums tax liability and $64,927.82 was due for 1970 retaliatory tax liability. Plaintiff contends for purposes of this litigation that $80,359.61 was due from it as 1970 premiums tax liability, and that no retaliatory tax for 1970 was due. The $79,157.85 difference between the 1970 premiums tax liability as computed by the Board and as computed by plaintiff is attributable solely to the questions of whether the terms of the 1966 amendment to article XIII, section 14 4/5, subdivision (e) is constitutional and whether it can be constitutionally applied to plaintiff.

11. (a) In its California premiums tax return and the supplement thereto for the year 1971 ("Exhibit H" included herein by reference in paragraph 4 above) plaintiff claimed that $219,187.37 was the gross premiums tax (exclusive of any retaliatory tax) payable by plaintiff due to its insurance business in California in the calendar year 1971. The amount of such tax was computed by plaintiff on the "California Company Basis". The return and supplement thereto claimed that the Principal Office Deduction allowable to plaintiff for said year was $120,354.69, leaving a net premiums tax of $98,832.68 claimed by plaintiff on the return as attributable to plaintiff's 1971 business in California, exclusive of any retaliatory tax. In addition to the calculation of the Principal Office Deduction on the "California Company Basis", plaintiff's return supplement also contained an alternative calculation of the Principal Office

Deduction in which plaintiff attempted to calculate said deduction in the manner prescribed by article XIII, section 14 4/5, subdivision (e) of the California Constitution as amended in 1966 and as applied to an Ohio corporation. By using such alternative calculation, the amount of the Principal Office Deduction was determined by plaintiff to be $42,190.28. Plaintiff, claiming that said 1966 amendment to the California Constitution was unconstitutional as applied to plaintiff, did not use the alternative calculation in arriving at the amount of premiums taxes it claimed to be due for the year 1971. Plaintiff's return correctly recited that plaintiff had made prepayments on account of said tax in the aggregate sum of $124,662.00. Thus, according to plaintiff's calculation the prepayments for the calendar year 1971 exceeded the amount of the premiums tax due for said year by $25,829.32. In addition plaintiff paid the Commissioner $125.00 as the fees claimed by the Commissioner for the year 1971 for the filing of plaintiff's annual statement and on account of its certificate of authority.

(b) For purposes of this litigation the parties agree that the factual allegations, figures, and computations shown on plaintiff's 1971 premiums tax return and supplement thereto are accurate except that defendant Board contends that the plaintiff's alternative figures for the Principal Office Deduction should have been used to determine the proper amount of the Principal Office Deduction (see paragraph 11 (c) below).

(c) At the time of the filing of its tax return for the year 1971, in addition to prepayments of $124,662.00, plaintiff paid under protest $52,335.09 representing the additional amount of tax which would have been due if the Principal Office Deduction were computed as shown in the alternative calculation on plaintiff's return supple-

ment. Plaintiff thus paid total gross premiums tax for 1971 (other than retaliatory tax) of $176,997.09, of which $78,164.41 was paid under written protest and asserted to be illegally claimed and collected. Said amount of $78,-164.41 was paid without awaiting an assessment by the defendant for said amount, in order to simplify the handling of plaintiff's claim for refund of said amount, for the defendant's convenience, and in accordance with plaintiff's letters of transmittal accompanying its tax payments.

(d) Plaintiff, after receiving written demand therefor from the Commissioner which threatened the imposition of mandatory penalties for any late filing thereof, filed, under protest, with the Commissioner, within the time provided by law, a Retaliatory Tax Information Return with respect to the business done by plaintiff in California during the year 1971. This return was reported on the basis of a California Principal Office Deduction of $120,-354.69. A full, true and correct copy thereof is attached hereto as "Exhibit Z" and by reference is made a part hereof.

(e) Defendant Board, on or about August 18, 1972, assessed and levied against plaintiff retaliatory tax in the amount of $65,434.96, and on or about August 18, 1972, defendant gave written notice to plaintiff that, on the recommendation of the Commissioner, such assessment had been made as retaliatory tax pursuant to section 12284 of the Revenue and Taxation Code of California on plaintiff's business done in California in 1971, and that plaintiff would become subject to penalty in the event such additional tax was not paid by December 1, 1972. The Commissioner and defendant Board computed such assessment of retaliatory taxes by subtracting plaintiff's California premiums tax liability of $176,997.09 (as computed by Commissioner and defendant Board using the alternative

computation on plaintiff's premiums tax return supplement for 1971) and the California fees of $125.00 set forth in paragraph 11 (a) above from $242,557.05, the sum of the Ohio premiums taxes and fees which would have been imposed on a similar California insurer transacting the same kind and amount of insurance business in the State of Ohio that plaintiff transacted in California. Such amount of Ohio premiums taxes and fees was computed by the Commissioner and defendant Board from the figures reported by plaintiff on page 2 of plaintiff's 1971 Retaliatory Tax Information Return ("Exhibit Z" to the Amended Complaint, included herein by reference in paragraph 11 (d) above) and does not include any real estate taxes which would have been payable to the State of Ohio or any subdivision of the State of Ohio. The parties agree that the figures reported on pages 2 and 3 of "Exhibit Z" are factually accurate.

(f) On or about August 23, 1972, plaintiff duly filed with defendant plaintiff's written petition for the correction of said retaliatory tax assessment on 1971 business, seeking the correction thereof to zero and the cancellation thereof. On the same date an executed duplicate copy of said petition was filed with the Commissioner.

(g) The defendant Board denied plaintiff's petition and so notified plaintiff on October 26, 1972.

(h) On or about November 27, 1972, in response to the demand of the defendant therefor and under the threat of penalty for nonpayment thereof, plaintiff paid to the State Controller the full amount of said additional assessment with respect to 1971 business, $65,434.96, under written protest set forth in plaintiff's letter of transmittal of payment.

(i) On or about April 30, 1973, plaintiff duly filed

with the defendant two duly executed written Claims for Credit and Refund of tax with respect to business done in 1971. One of such claims was filed with respect to the portion of the tax paid for the year 1971 which resulted from the denial to plaintiff of part of the Principal Office Deduction it had claimed in its return on the "California Company Basis"; the other claim was filed with respect to the portion of such tax designated as retaliatory tax. Copies of said claims are attached hereto and marked "Exhibits AA and BB" respectively, and the same are incorporated herein by this reference as if fully rewritten herein.

(j) Neither of said Claims for Credit and Refund was acted upon by defendant Board before the filing of the Amended Complaint by plaintiff pursuant to section 13104 of the Revenue and Taxation Code.

(k) Of the $242,432.05 set forth above as taxes paid by plaintiff for the year 1971, defendant Board presently contends that $176,997.09 was due for 1971 premiums tax liability and $65,434.96 was due for 1971 retaliatory tax liability. Plaintiff contends for purposes of this litigation that $98,832.68 was due from it as 1971 premiums tax liability, and that no retaliatory tax for 1971 was due. The $78,164.41 difference between the 1971 premiums tax liability as computed by the Board and as computed by plaintiff is attributable solely to the questions of whether the 1966 amendment to article XIII, section 14 4/5, subdivision (e) is constitutional and whether it can be constitutionally applied to plaintiff.

12. No part of the amounts paid under protest has been repaid to plaintiff, and no part thereof has been credited to plaintiff in respect to any other tax due the State of California from plaintiff.

13. There is no dispute between the parties as to the

accuracy of the figures which entered into the computation of the tax amounts at issue in this case as set forth in paragraphs 5 (k), 6 (n), 7 (m), 8 (m), 9 (l), 10 (l) and 11 (k).

14. The parties will make any computations necessary for inclusion in appropriate findings after the court's decision in this matter. In the event the parties are unable to agree on the computation, the case may be reopened by either party to submit any additional evidence which may be required in making such computation.

DATED: December 31, 1976.

PAUL, HASTINGS & JANOFSKY
/s/ By RONALD M. OSTER
Attorneys for Plaintiff

EVELLE J. YOUNGER
Attorney General of California
ERNEST P. GOODMAN
Assistant Attorney General

/s/ TIMOTHY G. LADDISH
Deputy Attorney General
Attorneys for Defendant

## EXHIBIT A TO THE STIPULATION OF FACTS

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
SAN FRANCISCO

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**Certificate of Authority**

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THIS IS TO CERTIFY, *That, pursuant to the Insurance Code of the State of California,* THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY *of* CINCINNATI, OHIO, *organized under the laws of* OHIO, *subject to its Articles of Incorporation or other fundamental organizational documents, is hereby authorized to transact within this State, subject to all provisions of this Certificate, the following classes of insurance:* LIFE AND DISABILITY *as such classes are now or may hereafter be defined in the Insurance Laws of the State of California.*

THIS CERTIFICATE *is expressly conditioned upon the holder hereof now and hereafter being in full compliance with all, and not in violation of any, of the applicable laws and lawful requirements made under authority of the laws of the State of California as long as such laws or requirements are in effect and applicable, and as such laws and requirements now are, or may hereafter be changed or amended.*

IN WITNESS WHEREOF, *effective as of the* 1st *day of* JULY, 1956, *I have hereunto set my hand and caused my official seal to be affixed this day of* AUG 27, 1956.

/s/ F. BURTON McCONNELL

(SEAL)

## AMENDED COMPLAINT FOR RECOVERY OF TAXES PAID UNDER PROTEST

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(Filed December 31, 1976)

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(CAPTION OMITTED IN PRINTING)

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Plaintiff complains of defendant and alleges as follows:

1. Plaintiff incorporates herein all of the facts contained and alleged in the Stipulation of Facts entered into by plaintiff and defendant and filed with the Court on ..... 1976.

2. By reason of the facts contained and alleged in said Stipulation, there is now due, owing and unpaid from defendant to plaintiff the sum of $977,853.57, together with interest as provided by Revenue and Taxation Code Sections 12983 and 13107 at the rate of six percent (6%) per annum as follows: on $128,214.90 from December 1, 1966, to date; on $78,042.57 from July 15, 1967, to date; on $52,517.91 from December 1, 1967 to date; on $3,072.38 from March 15, 1967, to date; on $72,900.38 from June 10, 1968, to date; on $60,270.01 from December 1, 1968, to date; on $81,917.80 from November 1, 1969, to date; on $65,390.47 from December 1, 1969, to date; on $81,576.55 from April 1, 1970, to date; on $66,265.56 from December 1, 1970, to date; on $76,446.55 from March 14, 1971, to date; on $67,639.12 from December 1, 1971 to date; on $78,164.41 from March 15, 1972, to date; and on $65,434.96 from December 1, 1972, to date.

WHEREFORE, plaintiff prays for judgment against defendant as follows:

1. For the sum of $977,853.57 together with interest thereon as alleged hereinabove;

2. For its costs of suit insurred herein; and

3. For such other and further relief as the court deems just and proper.

DATED: December 20, 1976.

PAUL, HASTINGS & JANOFSKY
RONALD M. OSTER

By /s/ RONALD M. OSTER
Ronald M. Oster
Attorneys for Plaintiff

Of Counsel:

Alan R. Vogeler
Lawrence H. Kyte
Gerald L. Baldwin
Kyte, Conlan, Wulsin & Vogeler
1300 Provident Tower
Cincinnati, Ohio 45202
(513) 421-5828

## STIPULATION RE FILING OF AMENDED COMPLAINT AND ANSWER THERETO

(Filed December 31, 1976)

(CAPTION OMITTED IN PRINTING)

IT IS HEREBY STIPULATED by and between the parties hereto, through their undersigned counsel of record, that plaintiff The Western and Southern Life Insurance Company may file herein an Amended Complaint in the form attached hereto as Exhibit "A".

IT IS FURTHER STIPULATED that upon the filing of said Amended Complaint, defendant State Board of Equalization of the State of California shall be deemed to have filed an answer thereto admitting the allegations contained in paragraph 1 of said Amended Complaint and denying each and every allegation contained in paragraph 2 of said Amended Complaint.

DATED: December 31, 1976

PAUL, HASTINGS & JANOFSKY
RONALD M. OSTER

By /s/ RONALD M. OSTER

Ronald M. Oster, Attorneys for Plaintiff The Western and Southern Life Insurance Company

DATED: December 28, 1976

EVELLE J. YOUNGER
Attorney General of California

ERNEST P. GOODMAN
Assistant Attorney General

TIMOTHY G. LADDISH
Deputy Attorney General

By /s/ TIMOTHY G. LADDISH
Timothy G. Laddish, Deputy Attorney General, Attorneys for Defendant State Board of Equalization of the State of California

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## SUPPLEMENTAL STIPULATION

(Filed May 24, 1977)

(CAPTION OMITTED IN PRINTING)

IT IS HEREBY STIPULATED AND AGREED by and between the parties hereto, through their respective attorneys of record, that Exhibit A attached hereto consists of a true copy of the analyses and the arguments to the voters concerning the 1966 amendment to article XIII, section 14-4/5, and that said Exhibit A is taken from pages 13 and 14 of the election brochure which was sent to each registered California voter prior to the general election of Tuesday, November 8, 1966.

Exhibit A is attached to this stipulation for the limited purpose of showing the contents of said analyses and arguments and not for the truth of the matters therein set forth; provided, however, that either party may offer said Exhibit A for additional purposes subject to objections as to competency, relevancy and materiality but not subject to the best evidence objection or any objection as to its genuineness or the due execution threof.

DATED: May 24, 1977

KYTE, CONLAN, WULSIN & VOGELER
ALAN R. VOGELER

PAUL, HASTINGS, JANOFSKY & WALKER
RONALD M. OSTER

By /s/ RONALD M. OSTER
Attorneys for Plaintiff

DATED: May 17, 1977

EVELLE J. YOUNGER, Attorney General of the State of California

ERNEST P. GOODMAN
Assistant Attorney General

/s/ TIMOTHY G. LADDISH
Deputy Attorney General
Attorneys for Defendant

EXHIBIT A

[COPIED FROM ORIGINAL]

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| 8 | TAXATION: INSURANCE COMPANIES; HOME OR PRINCIPAL OFFICE DEDUCTION. Legislative Constitutional Amendment. Establishes formula and limits amount of real property taxes on home or principal office buildings deductible from gross premiums tax by foreign insurers immediately, and by domestic insurers on home or principal office buildings commenced after January 1, 1970. Redefines term "insurer" so that reciprocal or interinsurance exchanges together with their attorneys in fact be considered as single unit. | YES | |
| | | NO | |

(For Full Text of Measure, See Page 32, Part II)

**General Analysis by the Legislative Counsel**

A "Yes" vote on this measure is a vote to limit the amount of the real property taxes on the home or principal office of certain insurance companies which may be deducted from the insurance tax, and to include corporate or other attorneys in fact of reciprocal or interinsurance exchanges within the constitutional definition of insurers which are subject to the insurance tax.

A "No" vote is a vote to retain this deduction in its

present form and to retain the existing definition of "insurer" in the Constitution.

For further details see below.

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**Detailed Analysis by the Legislative Counsel**

Section 14 4/5 of Article XIII of the State Constitution now provides, among other things, that each insurer shall pay an annual insurance tax, which is in lieu of all other state, county, and municipal taxes with specified exceptions, among which is the requirement that insurance companies pay property taxes on their real estate. However, an insurance company, other than an ocean marine insurer, is allowed to deduct from the insurance tax, the amount of property taxes paid on the real property which it owns and occupies as its home or principal office in this state. The property tax on the entire property is deductible, whether or not the insurer actually occupies the entire premises in which its home or principal office is located.

This measure, if adopted by the voters, would amend Section 14 4/5 to limit the amount of the home or principal office deduction by making it subject to a formula under which the deduction would be based on the percentage of the insurer's home or principal office building which the insurer is deemed to occupy, plus one-half of such percentage or 25 percent, whichever is less.

The limitation on the home or principal office deduction would not apply to real property owned by a domestic insurer organized under the laws of this state and licensed to transact insurance business in this state on or before December 31, 1966, when such real property is occupied by the insurer as its home or principal office on January 1, 1970, nor would it apply to such an insurer if

construction of its home or principal office commenced prior to January 1, 1970.

In addition, the measure would amend Section 14 4/5 to expand the definition of "insurer" to include the corporate or other attorneys in fact of reciprocal or interinsurance exchanges and require them to be considered as a single unit.

The measure would further provide that, even though a corporate or other attorney in fact would be treated as a unit with its reciprocal or interinsurance exchange and the unit would pay the insurance tax, each such attorney would be subject to all other taxes imposed upon businesses generally, except for income derived from its principal business as attorney in fact.

**Argument in Favor of Proposition No. 8**

This tax reform measure will increase state revenues by an estimated million dollars annually without imposing new taxes or increasing existing tax rates.

Insurance companies pay California an annual tax of 2.35% of the total amount of premiums received. This is called the gross premiums tax. The Constitution authorizes companies to deduct from their premium tax bill the amount of real property taxes paid by them on a single office building, which they designate as their "principal office". Over the years, this has offered an effective inducement for companies to build offices in California thereby stimulating the economy in return for some relief from California's exceptionally high gross premiums tax rate. This has worked out to the State's advantage.

A few companies, however, mostly from out-of-state, built

large office buildings and used only a small portion of the space for their insurance business, leasing the balance to tenants in competition with commercial building owners and operators. This caused understandable complaint from the owners of office buildings.

Proposition 8 solves this problem in a workable manner without unduly increasing the tax burden of the already heavily taxed insurance industry. This is done in the following manner:

New limitations are put on the use of the deduction for out-of-state companies and California companies licensed to transact insurance after 1966. For these companies, the new ground rules base the deduction on an occupancy formula. Under these rules a company's deduction of its real property taxes depends on the percentage of the building occupied by it and its insurance affiliates. The deduction is limited to the percentage of such occupancy plus an expansion or growth allowance. Thus, a company can claim the full deduction only if it occupies 75% or more of its building. As occupancy decreases, the deduction decreases.

This formula continues the spirit of the original deduction which has been beneficial to California's economy but modifies it to meet changing conditions and prevent serious abuse.

California's own companies with home offices are permitted to keep the full deduction until they move into a new building, at which time they become subject to the same formula. Therefore, long range, all companies will be on the formula.

This slight advantage given to California's home industry will bring California into line with the 26 other states

which give their home companies some form of tax advantage over out-of-state companies. Some states completely exempt their own companies from premium tax.

A purely technical change made by the measure brings the Constitution into conformity with a 1963 act of the Legislature designed to treat reciprocal insurers and their attorneys-in-fact as a single unit, rather than as separate entities. This unitary approach follows the Federal law and puts all domestic insurers in the same tax position.

This amendment received a unanimous vote in the Senate at the 1966 Session of the Legislature and only two negative votes in the eighty member Assembly. VOTE YES.

CHARLES EDWARD CHAPEL
Assemblyman, 46th District
STEPHEN P. TEALE
Senator, 26th District

**Argument Against Proposition No. 8**

This proposed constitutional amendment has two major defects and should be soundly rejected by the voters.

The first defect is that it gives a tax break to a small group of insurance companies by extending the provisions of the principal office deduction to attorneys-in-fact. In the next session, the Legislature will be faced with the necessity of making substantial changes in the state tax structure. If we are to start giving tax reductions, we should start by reducing taxes of the property owners of this state, rather than a small group of insurance companies.

The second defect of this measure is that it sets up a grossly discriminatory system of taxation in our state constitution. Out-of-state companies are to have, in effect, a

higher net insurance tax rate than in-state companies with the same type of principal office in California.

We should not use the power of government to give one firm a competitive advantage over any other. The end result of this will be a lessening of competition which will ultimately work to the disadvantage of the consumer. It is also setting a very bad precedent which could lead into a system of favoritism for certain firms through the use of the power of government.

Perhaps the most objectionable aspect to this whole procedure is that it is being sold to the people as a tightening up of an existing loophole. It is granted that this does reduce the principal office deduction for out-of-state insurance firms — but not California firms. This is what causes the objectionable discrimination. However, while closing this loophole it opens another by including the attorneys-in-fact in the definition of insurer. It is very questionable whether there will be any revenue advantage to the state by passage of this measure. At any rate, two defects which are cited above should be compelling reasons to defeat this measure. I am confident that the Legislature can work out a better solution to this problem than the one proposed.

E. RICHARD BARNES, Member
Assembly Committee on Revenue
and Taxation

SUPERIOR COURT OF CALIFORNIA,
COUNTY OF LOS ANGELES

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Honorable A. R. Early, Judge
Thomas Pulce, Deputy Sheriff
M. E. Stipe, Deputy Clerk
Reporter, (None)

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C-3189

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, a corporation

vs.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA

---

Counsel for Plaintiff:
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Ronald M. Oster

Of Counsel:
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Alan R. Vogeler

Counsel for Defendant:
Evelle J. Younger, Attorney Gen'l of California
by T. Laddish

Nature of Proceedings: Court's Intended Decision

In the above-entitled matter now submitted, judgment is for plaintiff for the full amount of tax refunds sought in accordance with the enclosed Memorandum Decision plus interest.

To dispose of all issues and avoid a possible retrial following appeal the court further finds as follows:

A. Plaintiff is barred from claiming that it should be treated herein as a California insurer because it failed to so claim in its claim for refund. R. & T. Code Section 13103. Cf. *American Chemical Corp.* vs. *County of Los Angeles* (1974) 42 C.A.3d 45 at 55-56, hearing denied, cert. den. 422 U.S. 1007.

B. To the extent that plaintiff's principal office deduction is allowed to plaintiff, its retaliatory tax will be correspondingly increased. The premium tax and the retaliatory tax are mutually interdependent.

C. The 1966 Amendment to California Constitution, Article XIII, Section 14-4/5 (e) and R. & T. Code Sec. 12441 were not intended by the law-makers to be retroactive and can not be applied to 1966 taxes. Cf. *Western & Southern Life Ins. Co.* vs. *State Board of Equalization* (1970) 4 C.A.3d 21, hearing denied, at 34-35.

The stipulation of facts on file herein is adopted as the court's findings of fact. Plaintiff is ordered to prepare appropriate conclusions of law and judgment, submit them to defendant for approval as to form and accuracy and then to the court for signature.

A copy of this minute order and a copy of the Memorandum Decision are mailed to all parties. A Certificate of Mailing is filed. MINUTES ENTERED Aug. 4, 1977

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

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Original Filed
August 4, 1977
County Clerk

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NO. C 3189

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, a corporation,
Plaintiff,

vs.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
Defendant.

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## MEMORANDUM OF INTENDED DECISION

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This case involves the constitutionality of taxes paid under written protest by plaintiff for the years 1965-71 inclusive pursuant to Insurance Code Section 685 and Article XIII, Section 14-4/5 (f) (3) of the California Constitution as that section was amended November 3, 1964, effective 1965 (now renumbered as Article XIII, Section 28). It also involves the constitutionality of a portion of the premiums taxes paid under written protest by plaintiff for the years 1966 through 1971 inclusive pursuant to Article XIII, Section 14-4/5 (e), as amended in 1966 so as to discriminate in favor of a "domestic insurer" as de-

fined therein and against insurers incorporated outside of California in the credit allowed against the premiums tax known as the home office deduction.

The facts herein are stipulated. They are accurately condensed at pages 1 to 5 of plaintiff's opening brief (see defendants trial brief at page 6, lines 5-7).

The tax imposed by Insurance Code Section 685 is referred to herein by both sides and in the Code as a "retaliatory tax," a confusing term because there are two different types of retaliatory tax. One type has been uniformly upheld by the appellate courts. This is a case of first impression dealing with the second type.

The plaintiff is an insurance carrier incorporated and having its principal office in Ohio. It has a Certificate of Authority for an indefinite term to do business in California issued pursuant to Insurance Code Section 701 which was effective July 1, 1956. Since that date, it has continually done business in this state. Prior to 1965, it constructed an office building on land it owns in this county, established its principal California office therein, and has so occupied it during all years pertinent herein.

## RETALIATORY TAX

Let us first examine the issue of the so-called "retaliatory tax." Following the Civil War, the insurance business expanded greatly and there were tremendous abuses. Regulation was needed, but there was no federal legislation to restrain the business. When state regulation was attempted, it was attacked as a violation of the Commerce Clause of the U. S. Constitution. In *Paul* v. *Virginia,* 8 Wall. 168 (U.S. 1868), the United States Supreme Court permitted such state regulation to continue by holding that the insurance business was not commerce at all. *Accord*: *Hooper* v. *California* (1895) 155 U.S. 648, 655, and *New York Life*

*Insurance Co.* v. *Deer Lodge County* (1913) 231 U.S. 495. A great number and variety of state taxes and regulations then developed, some of which strongly discriminated taxwise in favor of locally incorporated insurers as against those incorporated in other states but also doing business locally. As an antidote to such tax discrimination by other states against local insurers when doing business in those other states, local legislatures often adopted a "retaliatory tax" against out-of-state insurers when doing business locally. Writing under the direction of Prof. Robert E. Keeton in 39 Notre Dame Lawyer 243 (1964), George Pelletier, Jr., states that such statutes had then been adopted in 45 states, noting that they vary considerably in detail.

The purpose of such a retaliatory tax, according to defendant, "is to secure for the insurance companies of the enacting state even-handed treatment by the other states" (DTB 11, lines 11-14). This is a quotation from *Western & Southern Life Insurance Co.* v. *State Board of Equalization* (1970) 4 Cal. App. 3d 21, at 34. In *Atlantic Insurance Co.* v. *State Board of Equalization* (1967) 255 Cal. App. 2d 1 (hear. den.) cert. den. 390 U.S. 529, at page 4, the opinion states that "The common purpose of such legislation in the several states has been to discourage any state from imposing discriminatory taxes or other burdens upon out-of-state companies." And at page 15, the opinion says that "here the purpose of the retaliatory law is to secure reciprocity (citations omitted) . . . . It is designed to achieve uniformity and not to discriminate."

The opinion in *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 Pac. 2d 726, affirmed (per curiam) in *Prudential Insurance Co. of America* v. *Hobbs* (1946) 328 U.S. 822, expressed the object of a retaliatory tax in similar terms: "It seems to us more justly to be deemed a provi-

sion for reciprocity. It says, in effect, that while we recommend all insurance corporations of other states to the transaction of business within our limits, we insist upon a like recommendation elsewhere, and that if other states shall attempt, directly or indirectly, to debar our corporations from the transaction of insurance business within their borders we shall meet their corporations with the same restrictions and disability. It is, in brief, an appeal for comity; a demand for equality" (161 Pac. 2d 730). Are these objectives served by the type of retaliatory tax before the court herein? We think not. Let us examine that tax.

That there are two different types of retaliatory tax was expressly recognized by the opinion in the *Atlantic Insurance Company* case, *supra,* at page 5. That opinion contrasted the retaliatory tax authorized by Article XIII Section 14-4/5 (f) (3) of the California Constitution as it read *before* it was amended November 3, 1964 with the different type of retaliatory tax authorized by Insurance Code Section 685. The Constitutional provision (now changed) then authorized tax retaliation against insurers from another state only when the tax laws of that state discriminated against California insurers in favor of its domestic insurers, thus giving its domestic insurers a competitive advantage over California insurers within its borders. Unless the context indicates otherwise, as used hereinafter the word "taxes" includes taxes, licenses, fees, and other financial exactions in the aggregate. Section 685 on the other hand imposed a "retaliatory tax upon foreign insurance companies whose home states levied higher taxes upon California companies than California imposed upon companies from those foreign states" (irrespective of whether the foreign state discriminated against California companies or taxed them exactly the same as it did its

domestic companies). The first type of tax is identified in the opinion as a "discriminatory tax," whereas the second is described as a "comparative retaliatory tax" (255 Cal. App. 2d 5). A term more descriptive of the first type, which I will hereinafter use, would be an "anti-discrimination retaliatory tax." It is obvious that the objective described above of discouraging other states from imposing discriminatory taxes on California insurers is effectively served by the anti-discrimination retaliatory tax and is not served at all by the "comparative retaliatory tax." The tax involved herein is of the latter type. A "comparative retaliatory tax" is not really retaliatory at all. It does nothing to prevent discriminatory by other states. It does not insure even-handed treatment by those states of California insurers. If anything, it would seem to stimulate counter discrimination against California carriers.

In 1944 the U. S. Supreme Court overturned its 1868 decision in *Paul* v. *Virginia, supra,* and in *United States* v. *South-Eastern Underwriters Association* (1944) 322 U.S. 533 it was held that insurance was commerce after all, and could be interstate commerce. Congress, however, did not then undertake to exercise its power under the Commerce Clause to regulate the interstate insurance business. Instead, it enacted the McCarran-Ferguson Act (59 Stat. 33; 15 U.S.C. Sections 1011-1015) which returned authority to regulate and tax the insurance industry to the states. As the Act did not purport to repeal any part of the United States Constitution, the authority of the states is, of course, limited by that Constitution's constraints. Just what limits does the federal Constitution place upon the power of the states to tax interstate commerce? One percipient scholar and legal satirist, the late Professor T. Reed Powell, once said that if the American Law Institute were to restate the law of state taxation of interstate commerce, it would read as follows:

**State Power to Tax Interstate Commerce**

The states may tax interstate commerce.

Comment: The states may not tax interstate commerce too much.

Caveat: How much is too much is beyond the scope of this restatement.

Professor Powell was echoing the laments of members of the Court itself epitomized in the opinion in *Portland Cement Co.* v. *Minnesota* (1959) 358 U.S. 450, at 457-458:

> "Commerce between the States having grown up like Topsey, the Congress meanwhile not having undertaken to regulate taxation of it, and the States having understandably persisted in their efforts to get some return for the substantial benefits they have afforded it, there is little wonder that there has been no end of cases testing out state tax levies. The resulting judicial application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation. This Court alone has handed down some three hundred full-dress opinions spread through slightly more than that number of our reports. As was said in *Miller Bros. Co.* v. *Maryland,* 347 US 340, 344, 98 L ed 744, 748, 74 S Ct 535 (1954), the decisions have been 'not always clear . . . consistent or reconcilable. A few have been specifically overruled, while others no longer fully represent the present state of the law.' From the quagmire there emerge, however, some firm peaks of decision which remain unquestioned."

In *Prudential Ins. Co.* v. *Benjamin* (1946) 328 U.S. 408, 420, the opinion summarizes the situation as "one of very considerable judicial oscillation." However, even in that era of uncertainty, as stated in *Portland Cement, supra,* there were "some firm peaks of decision which remain unquestioned." Significant herein among those landmarks is the principle that "no State may impose a tax which discriminates against interstate commerce . . . . by providing a direct commercial advantage to local business" (citing cases) (358 U.S. at 458). *Accord: Richfield Oil Corp.* v. *State Board of Equalization* (1946) 329 U.S. 69, at 76, and *Hanover Fire Insurance Co.* v. *Harding* (1926) 272 U.S. 494. This language was quoted approvingly by a unanimous court in *Boston Stock Exchange* v. *State Tax Commission* (1977) 50 L.ed. 2d 514 at 524. The reason behind the rule was simply stated:

> ". . . the very purpose of the Commerce Clause was to create an area of free trade among the several states. . . . The prohibition against discriminatory treatment of interstate commerce follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses would invite a multiplication of preferential trade areas destructive of the free trade which the Clause protects."

Cases to this effect are legion. Even Alexander Hamilton wrote, "An unrestrained intercourse between the States themselves will advance the trade of each, by an interchange of their respective productions, not only for the supply of reciprocal wants at home, but their exportation to foreign markets." THE FEDERALIST No. 11, at 52 (Cooke ed. 1961).

Another recognized landmark is the principle that a

state may tax interstate commerce so that it will carry "its fair share of the costs of state government in return for the benefits" and services it derives from the state. *Richfield Oil Corporation* v. *State Board of Equalization, supra,* 329 U.S. at 75. *Portland Cement Co.* v. *Minnesota, supra,* 358 U.S. at 462. *Complete Auto Transit, Inc.* v. *Brady* (1977) 51 L.ed. 2d 326 at 336.

In other words, "Interstate commerce may be made to pay its way."

The retaliatory taxes herein were levied pursuant to Insurance Code Section 685 and California Constitution Art. XIII, Section 14-4/5 (f) (3) as amended November 3, 1964, upon plaintiff, an insurance carrier incorporated in Ohio. During none of the years pertinent herein did Ohio discriminate against California carriers doing business in Ohio; Ohio imposed the same burdens and taxes on its domestic insurers that it did on California carriers doing business in Ohio. Ohio apparently had a retaliatory tax similar to California's which never became applicable herein because the taxes and burdens Ohio imposed on companies doing business in Ohio were greater than those imposed by California on its domestic insurers.

During this period, the California retaliatory tax was of the type described in the *Atlantic Ins. Co.* case, *supra,* at page 5 as a "comparative retaliatory tax." California imposed its premiums tax upon plaintiff each year and in addition thereto imposed a "retaliatory tax" which represented the difference between the California premiums tax paid by plaintiff and the aggregate taxes that a California company would have had to pay in Ohio upon the same volume of business done therein. The California premiums tax is an "in lieu" tax and, except for real property taxes (which are also paid by foreign carriers), *no other taxes were imposed by California on its own domestic*

*carriers.* Recognition of this fact is essential to the finding that the California retaliatory tax discriminates against the plaintiff herein. As amended on November 3, 1964, the California Constitution no longer requires that Ohio discriminate against California's insurers doing business in Ohio before California's "retaliatory tax" becomes applicable. This California tax is plainly discriminatory against interstate commerce. No reasonable ground for this discriminatory classification has ever been suggested. The tax has no relationship whatsoever to the benefits or services that the state furnishes a foreign carrier. It is a burden on interstate commerce which directly affects it by making it more costly relative to similar intrastate commerce which does not bear this burden. Tax discrimination is equally onerous whether cast in the form of a license tax, a property tax, a premium tax, an income tax, or a franchise tax. It provides a direct commercial advantage to domestic businesses at the expense of out-of-state businesses.

No California court has every squarely upheld such a discriminatory tax. No federal court has ever upheld a "comparative retaliatory tax" where it was proved that the effect of that tax was discriminatory.

Defendant argues that California has the power to impose a discriminatory tax upon foreign corporations as a condition of their right to continue to do business in California. Let us examine some of these cases upon which defendant relies.

*Prudential Ins. Co.* v. *Benjamin* (1946) 328 U.S. 408 upheld a premiums tax imposed by South Carolina on out-of-state insurers but not imposed on domestic insurers. Viewed in isolation, this appears to be discriminatory. However, South Carolina denied discrimination (at 411, 412) and the opinion recites that the record did not estab-

lish that the tax was discriminatory in effect when the other taxes paid by domestic carriers but not paid by out-of-state carriers were considered (fn. 36, 3rd paragraph). The Court, however, "assumed" that the tax would be discriminatory in certain other senses (at 428, fn 36 and fn 4). It nevertheless upheld the tax on the ground the Congress had consented thereto in the McCarran-Ferguson Act, simultaneously acknowledging that Congress had no power "to subvert constitutional limitations" (at 430).

The tax upheld was not a so-called "retaliatory tax" of either type. The opinion expressly disclaimed approval of such a tax. In fn 40, it referred to allegedly similar tax statutes of sixteen other states and said that "We express no opinion concerning the validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein." A retaliatory tax hardly qualifies as "substantially identical."

Shorn of its dicta, the *Benjamin* case upheld a tax which the record therein failed to establish was discriminatory (328 U.S. at 428, fn. 36). It was not even a retaliatory tax. This undermines the conclusion (perhaps an inadvertence) expressed in the opinion in *Franklin Life Ins. Co.* v. *State Board of Equalization* (1965) 63 Cal. 2d 222 in fn. 2. It is also self evident that by the McCarran-Ferguson Act, Congress could not effectively consent to state taxation which violates the due process clause of the United States Constitution. Even the *Franklin Life* opinion acknowledges (63 Cal. 2d at 226) that "Of course, any attempt to assess a retaliatory tax against an insurer from a state which does not discriminate against California insurers, would constitutionally fail." Amen! This statement is echoed at page 5 of the opinion in *Atlantic Ins. Co.* v. *State Board of Equalization* (1967) 255 Cal. App. 2d 1 (hear. den.), cert. den. 390 U.S. 529.

Defendant relies on *In Re Insurance Tax Cases* (1945) 160 Kan. 300, 161 Pac. 2d 726 which was affirmed (per curiam) hortly after the *Benjamin* decision sub. nom. *Prudential Ins. Co.* v. *Hobbs* (1946) 328 U.S. 822. This involved several Kansas taxes including a so-called "retaliatory tax" on out-of-state insurers similar in form, but not in effect, to that herein. The Kansas court rejected the contention that the tax discriminated against out-of-state insurers. To quote it:

> "Plaintiffs contend the tax in question is void because of discrimination between foreign and domestic insurance companies. It is true that demostic insurance companies are taxed on a different basis. They are not required to pay a tax measured by their premiums, but they are required to pay a capital stock tax . . . . and a tax upon the net value of their assets . . . The fact that the tax on domestic companies is upon a different basis than that upon foreign companies does not of itself render the tax invalid . . . . We are unable to find in the record evidence to support the view that the tax in question upon foreign insurance companies is greater than that levied on the home insurance companies." (166 Pac. 2d at 734).

The approach taken by the Kansas court has recently been approved. Referring with approval to earlier opinions cited in fn. 8, in *Complete Auto Transit, Inc.* v. *Brady* (1977) 51 L.ed. 2d 326, the unanimous opinion notes that "these decisions have considered not the formal language of the tax statute, but rather its practical effect . . . ." (at 331). At the same page, the opinion notes that he permissibility of state taxation is "based on the actual effect rather than its legal terminology." Even the *Benjamin* opinion at page 420 states that in resolving these problems

there should be "emphasis on facts rather than dogmatic logistic." Or, as Chief Justice Taft put it at page 510 of the opinion in *Hanover Fire Ins. Co.* v. *Harding* (1926) 272 U.S. 494, ". . . the decision is not dependent upon the form in which the taxing scheme is cast . . . . We must regard the circumstances rather than the form."

Approval by the United States Supreme Court of non-discriminatory taxes in the *Benjamin* and *Hobbs* cases gives little support to defendant's contentions.

We have already mentioned the *Franklin Life Ins. Co.* case, *supra.* That opinion dealt with 1960 retaliatory taxes. At that time, the California Constitution, Art. XIII, Section 14-4/5 (f) permitted such taxes only against "foreign insurers of states discriminating against California insurers" (63 Cal. 2d 222 at 226; also see 233). It does not support such a tax against insurers from states like Ohio which do not discriminate against California insurers. To the contrary, at page 226 the opinion states that ". . . any attempt to assess a retaliatory tax against an insurer from a state which did not discriminate against California insurers would constitutionally fail."

*Atlantic Insurance Co.* v. *State Board of Equalization* (1967) 255 Cal. App. 2d 1 (hear. den.) cert. den., is also relied upon by defendant. It involved 1959 and 1960 taxes when the law was the same as that governing the *Franklin Life* case and the same result was reached. At page 5 the opinion acknowledges that "the new statute would be unconstitutional if applied to a case where the discrimination . . . is not present." *See* also page 15.

When the express reason for sustaining the constitutionality of California's retaliatory tax has been repealed and its effect is discriminatory, the resulting law is so different that these opinions do not support it. *Western & Southern*

*Life Insurance Co.* v. *State Board of Equalization* (1970) 4 Cal. App. 3d 21 (hear. den.) involved 1964 retaliatory taxes. Before 1964, the California Constitution had imposed a premiums tax on foreign and domestic insurers alike. When the tax laws of another state discriminated against California insurers in favor of its domestic insurers, California also imposed retaliatory taxes on insurers from that state doing business in California. Effective November 4, 1964, the California Constitution was amended to eliminate the discrimination requirement and thereafter imposed the tax on a foreign insurer when its state of incorporation taxed California insurers more than California would have done – even in the absence of any discrimination by that state. The opinion held that the amendment could not be applied retrospectively and therefore could not be considered in determining 1964 taxes. Dicta in the opinion (at page 30) states that "The California retaliatory tax law does not violate . . . the United States Constitution." The opinion fails to distinguish between the pre-1964 anti-discrimination retaliatory tax and the post-1964 comparative retaliatory tax. It fails to note that the cases cited have upheld taxes only when no discriminatory effect was proved. It also cites the *Atlantic Insurance Co.* case, altogether ignoring the statement therein that "the new statute would be unconstitutional if applied to a case where the discrimination . . . is not present" (255 Cal. App. 2d 1 at 5).

We are persuaded that the more authoriative and convincing dicta is that noted above from *Franklin Life Insurance Co.* v. *State Board of Equalization* (1965) 63 Cal. 2d 222 at 226. We find that the retaliatory tax herein is discriminatory in fact and violates both the due process and commerce clauses of the United States Constitution.

**Principal Office Deduction from the Gross Premiums Tax**

The second tax involved herein is the gross premiums tax levied pursuant to former California Constitution, Art. XIII Section 14-4/5 (f) (3) which was imposed upon all insurers, out-of-state and domestic, in lieu of all other taxes and licenses except real estate taxes. Plaintiff does not challenge the basic tax. It challenges the denial (pursuant to the 1966 amendment) to it as an out-of-state insurer of the credit against that tax for the payment of local real property taxes, which credit is granted to domestic insurers.

That this principal office deduction was altogether repealed in 1976 is irrelevant herein.

Denial of this credit to plaintiff solely because it is an out-of-state insurer obviously creates a "direct commercial advantage to local business." It is a backhanded way of granting a property tax exemption to domestic insurers while denying it to out-of-state insurers. It invokes the rule that where a taxpayer's federal constitutional rights are concerned, the courts will not be governed by the label that a state attaches to a taxing device (here a privilege tax) but by the practical consequences of the tax measured against constitutional standards.

Obviously such a discriminatory credit for other taxes paid could not stand constitutional testing if applied to an income tax, or to a gross receipts tax. Nor is discriminatory property taxation permitted.

Defendant seeks to sustain this tax credit because the tax upon which it is applied analytically is a franchise tax or a privilege tax. It remains a tax in lieu of income taxes; why should it have different legal consequences?

Defendant argues that this tax credit is valid, that California may discriminatorily tax an out-of-state corporation as a condition for the privilege of doing business in California. The more recent decisions of the United States

Supreme Court do not support this contention. For background material see the illuminating discussion of *Unconstitutional Conditions* in 73 Harvard L.R. 1595 (1960) at 1605-1609.

Quite recently the unanimous opinion of the United States Supreme Court in *Complete Auto Transit, Inc.* v. *Brady* (1977) 51 L.ed. 2d 326 at 337 held that "There is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscrues the question whether the tax produces a forbidden effect." Ignoring the form in which the principal office deduction is cast and focusing attention on whether it produces a "forbidden effect," we find such an effect – discrimination against interstate commerce because it is interstate commerce.

Thirty years ago in *Freeman* v. *Hewit* (1946) 329 U.S. 249 at 252 the United States Supreme Court said, with reference to the many opinions that are pertinent to this subject, "To attempt to harmonize all that has been said in the past would neither clarify what has gone before nor guide the future." This court is encouraged by the readiness with which the United States Supreme Court has recently overturned some of the historically unsound and illogical precedents in the field of state taxation. Just this year *Spector Motor Service* v. *O'Connor* (1951) 340 U.S. 602 was specifically and unanimously overruled by *Complete Auto Transit, Inc.* v. *Brady, supra.* Just last year, in *Michelin* v. *Wages* (1976) 423 U.S. 276 the court unanimously overruled *Low* v. *Austin* (1872) 80 U.S. (13 Wall.) 29. Thus encouraged, and with the original purposes of the due process, equal protection and commerce clauses in mind, and following the more recent reasoning and analysis of these matters by our highest court, this court concludes that the denial by defendant to plaintiff of

the principal office deduction is an unconstitutional discrimination, that the California constitutional provision and statute mandating such denial violates the United States Constitution and that, therefore, plaintiff is entitled to that credit for all tax years pertinent herein.

DATED: August 4, 1977.

/s/ A. R. EARLY
JUDGE OF THE
SUPERIOR COURT

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SUPERIOR COURT OF THE STATE OF
CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

---

THE WESTERN AND SOUTHERN LIFE
INSURANCE COMPANY, a corporation,
Plaintiff,

v.

STATE BOARD OF EQUALIZATION OF
THE STATE OF CALIFORNIA,
Defendant.

---

No. C 3189

---

## CONCLUSIONS OF LAW

The above entitled cause came on regularly for trial on June 10, 1977, in Department 15 of the above entitled court, the Honorable Alexander R. Early, Judge presiding, plaintiff The Western and Southern Life Insurance Company appearing by Messrs. Kyte, Conlan, Wulsin & Vogeler

by Alan R. Vogeler, Esq. and by Messrs. Paul, Hastings, Janofsky & Walker by Ronald M. Oster, Esq., and defendant State Board of Equalization of the State of California appearing by Evelle J. Younger, Attorney General of California, by Timothy G. Laddish, Esq., and the parties having agreed to a Stipulation of Facts, and trial briefs having been filed by the parties' respective counsel, and the cause having been argued and submitted for decision, the court, having adopted the parties Stipulation of Facts as its written Findings of Fact, does hereby make in writing its Conclusions of Law, as follows:

1. The carrying on within a state of an insurance business by a corporation incorporated in another state constitutes interstate commerce.

2. The authority to regulate and tax the insurance industry given to the states by the McCarran-Ferguson Insurance Regulation Act, 59 Stat. 33, 15 U.S.C. §§ 1011-15, could not and did not eliminate the restraints on state action in the Constitution of the United States.

3. While a state may tax interstate commerce so that it carries its fair share of the costs of state government in return for the benefits and services it derives from the state, no state may impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business.

4. Prior to November 3, 1964 California authorized tax retaliation against insurers from another state only when the tax laws of that state discriminated against California insurers in favor of its domestic insurers, thus giving the latter a competitive advantage over California insurers within its borders. This type of law can appropriately be called an "anti-discrimination retaliatory tax."

5. The amendment of Article XIII, Section 14-4/5 (f) (3) of the California Constitution on November 3, 1964

purported to authorize and Insurance Code Section 685 imposed tax retaliation against insurers from another state in the years here involved when the laws of that state levied higher taxes upon California insurers doing business in that state than California imposed upon insurance companies from that state doing business in California, irrespective of whether the other state discriminated against California companies or taxed them exactly the same as it did its domestic companies. This type of law appropriately has been called a "comparative retaliatory tax".

6. The objective of California retaliatory taxes is to discourage other states from imposing discriminatory taxes on California insurers. That objective is effectively served by an "antidiscrimination retaliatory tax" and is not served at all by the "comparative retaliatory tax".

7. In none of the years here pertinent did the State of Ohio discriminate against California insurance companies doing business in Ohio, imposing the same burdens and taxes on its domestic insurers that it imposed on California insurance companies doing business in Ohio.

8. Section 685 of the California Insurance Code and Article XIII Section 14-4/5 (f) (3) of the California Constitution impose a comparative retaliatory tax which neither prevents discrimination by other states nor insures even-handed treatment by those states of California insurers.

9. The California retaliatory tax as effective for the years 1965 and following discriminates against insurers from other states, including Ohio, thereby providing a direct commercial advantage to local business and discriminated against interstate commerce, and, therefore, violates both the due process and commerce clauses of the United States Constitution.

10. The denial to a foreign insurer of a credit against the California premiums tax for real property taxes paid

in California on the principal office in California of such foreign insurer under the 1966 amendment to Article XIII Section 14-4/5 (e) of the California Constitution and the 1967 amendment to Revenue and Taxation Code Section 12241 grants a property tax exemption to domestic insurers while denying it to an out-of-state insurer. This change in the law was not intended to be retro-active and is inapplicable to 1966 taxes.

11. The gross premiums tax imposed by Article XIII, Section 14-4/5 of the California Constitution on insurers doing business in the State of California is in lieu of all other taxes except real estate taxes.

12. Article XIII, Section 14-4/5 (e) of the California Constitution, together with Section 12241 of the California Revenue and Taxation Code purported to grant a credit against the gross premiums tax to local insurers for real estate taxes paid to the State of California while denying such a credit to out-of-state insurers.

13. Granting such a credit to local insurers while denying such a credit to out-of-state insurers discriminates against interstate commerce by creating a direct commercial advantage to local business.

14. Just as a discriminatory credit for taxes paid constitutionally would fail as applied to an income tax or a gross receipts tax, so also it is unconstitutional as applied to property taxation.

15. Irrespective of whether the gross premiums tax may be characterized as a franchise or privilege tax, it remains a tax in lieu of income taxes and discrimination in such a tax has the same legal consequences as discrimination in an income tax.

16. Discrimination in granting a credit for real estate taxes against the gross premiums tax is prohibited by the due process and equal protection clauses of the Fourteenth

Amendment to, and by the commerce clause of Article I, Section 8, Clause 3, of the United States Constitution.

17. The gross premiums tax imposed by Article XIII, Section 14-4/5 of the California Constitution and the retaliatory tax imposed by Article XIII, Section 14-4/5 (f) (3) and Section 685 of the California Insurance Code are mutually interdependent, and to the extent that a credit against the gross premiums tax is allowed, the retaliatory tax is correspondingly increased.

18. Sections 12432 and 12290 of the California Revenue and Taxation Code do not bar the collection of additional retaliatory taxes not asscessed by the state within the period set forth therein when an out-of-state insurer successfully contests the assessment of a portion of the gross premiums tax and secures a reduction in such assessment.

19. Plaintiff is barred from claiming that it should be treated as a California insurer because it failed to raise this issue in its claim for refund.

20. Plaintiff is entitled to judgment for the full amount of tax refunds sought, plus interest as provided by statute.

DATED: .....

.....
Judge of the Superior Court

Approved as to form and conformity
with Memorandum of Intended Decision
and Minute Order, filed August 4, 1977.

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SUPERIOR COURT OF THE STATE OF
CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

---

Filed October 27, 1977

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THE WESTERN AND SOUTHERN LIFE
INSURANCE COMPANY, a corporation,
Plaintiff,

v.

STATE BOARD OF EQUALIZATION OF
THE STATE OF CALIFORNIA,
Defendant.

---

No. C 3189

---

## JUDGMENT

IT IS ORDERED, ADJUDGED AND DECREED that plaintiff The Western and Southern Life Insurance Com-

pany have judgment against defendant State Board of Equalization of the State of California in the sum of $977,853.57, together with costs, and interest (at the rate of 6 percent per annum through December 31, 1975, and at the rate of 12 percent per annum thereafter) computed pursuant to section 13107 of the Revenue and Taxation Code on the following amounts from the following dates: on $128,214.90 from November 25, 1966; on $78,042.57 from July 14, 1967; on $52,517.91 from November 24, 1967; on $3,072.38 from March 15, 1968; on $72,900.38 from June 10, 1968; on $60,270.01 from November 29, 1968; on $81,917.80 from October 13, 1969; on $65,390.47 from November 21, 1969; on $81,576.55 from March 26, 1970; on $66,265.56 from November 30, 1970; on $76,-446.55 from March 29, 1971; on $67,639.12 from November 23, 1971; on $78,164.41 from March 27, 1972; and on $65,434.96 from November 27, 1972.

DATED: 27 October 1977

/s/ A. R. EARLY
Judge of the Superior Court

Approved as to form and conformity
with Memorandum of Intended Decision
and Minute Order, filed August 4, 1977.

PAUL, HASTINGS, JANOFSKY & WALKER
By: /s/ RONALD M. OSTER
Attorneys for Plaintiff

EVELLE J. YOUNGER
By: /s/ TIMOTHY G. LADDISH
Attorneys for Defendant

CERTIFIED FOR PUBLICATION

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IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FOUR

---

2 Civ. No. 55251
(Super Ct. No. C-3189)

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THE WESTERN AND SOUTHERN
LIFE INSURANCE COMPANY,
Plaintiff and Respondent,

v.

STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA,
Defendant and Appellant.

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(Filed November 2, 1979)

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APPEAL from a judgment of the Superior Court, Los Angeles County. Alexander R. Early III, Judge. Reversed.

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George Deukmejian, Attorney General, Ernest P. Goodman, Assistant Attorney General, and Timothy G. Laddish, Deputy Attorney General, for Defendant and Appellant.

Frost & Jacobs, Alan R. Vogeler, Gerald L. Baldwin, Paul, Hastings, Janofsky & Walker, and Ronald M. Oster for Plaintiff and Respondent.

This case involves the constitutionality of two provisions of California law imposing taxes on foreign insurance companies. The trial court found in favor of the plaintiff insurance company, holding that one of those provisions (the so-called retaliatory tax) was unconstitutional. It also made findings on other issues as set forth in its memorandum of intended decision as follows:

"In the above-entitled matter now submitted, judgment is for plaintiff for the full amount of tax refunds sought in accordance with the enclosed Memorandum Decision plus interest.

"To dispose of all issues and avoid a possible retrial following appeal the court further finds as follows:

"A. Plaintiff is barred from claiming that it should be treated herein as a California insurer because it failed to so claim in its claim for refund. R. & T. Code Section 13103. Cf. *American Chemical Corp.* v. *County of Los Angeles* (1974) 42 C.A.3d 45 at 55-56, hearing denied, cert. den. 422 U.S. 1007.

"B. To the extent that plaintiff's principal office deduction is allowed to plaintiff, its retaliatory tax will be correspondingly increased. The premium tax and the retailatory [sic] tax are mutually interdependent.

"C. The 1966 Amendment to California Constitution, Article XIII, Section 14-4/5 (e) and R. & T. Code Sec. 12441 were not intended by the law-makers to be retroactive and can not be applied to 1966 taxes. Cf *Western & Southern Life Ins. Co.* v. *State Board of Equalization* (1970) 4 C.A.3d 21, hearing denied, at 34-35.

"The stipulation of facts on file herein is adopted as the court's findings of fact. Plaintiff is ordered to prepare appropriate conclusions of law and judgment, submit them to defendant for approval as to form and accuracy and then to the court for signature."

The case was submitted on a stipulation of facts. They may be summarized as follows:

Plaintiff is an Ohio corporation, licensed in 1956 to do business in California. While its principal office is in Ohio it owns a building in Los Angeles which it utilizes as its principal office for California. Approximately 76% of that building is leased by it to tenants not connected with the operations of plaintiff. The taxes imposed by Ohio, on a California corporation doing business in Ohio, exceed the taxes imposed on foreign corporations doing business in California, under the basic premium tax imposed by California. The "retaliatory tax" herein involved imposes on plaintiff (and similar insurers) an additional tax equal to that difference. It is the validity of that additional tax that is the principal issue in this case.

Prior to 1966, California allowed an insurance company to deduct from its premium tax, the amount of local property tax imposed on its principal office in this state; by an amendment in that year, the real property tax deduction was amended so that foreign insurers,[1] but not domestic insurers, were limited to a deduction equal only to the proportion of such taxes attributable to the portion of the home office building used by insurer. The effect, therefore, was to impose on a foreign insurer a larger premium tax than that imposed on domestic insurers.

## I

Retaliatory taxes, in some form, exist in at least 49 states. The purpose, as set forth in many cases and in the

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[1] As used herein, and in the literature on the subject, a "foreign" insurance company is one incorporated and having its principal office in a state other than the state imposing the taxes; a "domestic" insurance company is one incorporated in, and having its principal office, in the state imposing the taxes.

literature discussing them, is to put pressure on the several states to impose the same tax burden on all insurance companies, foreign or domestic, and thereby encourage the doing of interstate business.

Prior to 1964, the California Constitution provided for a retailatory [sic] tax involving two elements: a tax on *discriminatory* taxes, i.e., taxation of a California insurer doing business in the home state of a foreign insurer, at a higher rate than that state imposed on its own insurers; and (2) a tax on *comparative* taxes such as the one herein involved. At that time, the statutory law imposed a retailatory [sic] tax only on the comparative theory. In 1964, the California Constitution was amended to delete the provision relating to discriminatory taxes and thereafter both the California Constitution and the statute used parallel language imposing only the comparative tax.

In cases involving the applicability of the pre-1964 tax scheme, the courts held that, because the California Constitution required that a tax imposed by the home state of a foreign insurer involve both the discriminatory and the comparative feature, the statutory attempt to impose a retaliatory tax in situations involving only the comparative tax was invalid as being beyond the California constitutionally granted power of taxation.[2] We agree with plaintiff that the *holding* of those cases was limited to that issue, although there is language, relied on here by defendant, that can be read as sustaining the constitutionality of the present comparative provisions. We turn then, to consider the issue herein involved with no binding California precedent, although the language relied on by defendant is, of course, entitled to our respect.

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[2] *Franklin Life Ins. Co.* v. *State Bd. of Equalization* (1965) 63 Cal. 2d 222; *Atlantic Ins. Co.* v. *State Bd. of Equalization* (1967) 255 Cal. App.2d 1.

For many years, under the compulsion of *Paul* v. *Virginia* (1868) 75 U.S. (8 Wall.) 168, which had held that the business of insurance was not "commerce" within the meaning of the Commerce Clause of the federal Constitution, the states had imposed a variety of retaliatory taxes. In 1944, in *United States* v. *South-Eastern Underwriters Assn.* (1944) 322 U.S. 533, the Supreme Court overruled *Paul* v. *Virginia* and held that the business of insurance was within the commerce clause. Shortly thereafter, Congress enacted the so-called McCarran Act (59 Stats. 33, 15 U.S.C. §§ 1011-1015). That statute provided that "the business of insurance . . . shall be subject to the law of the several States which relate to the regulation or taxation of such business." In *Prudential Ins. Co.* v. *Benjamin* (1946) 328 U.S. 408, the Supreme Court construed that statute and concluded that Congress had "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause to whatever extent this may be done with the force of that power behind it. . . ." (328 U.S. at 431). We conclude that that decision, and other cases following it,[3] compel us to reject plaintiff's contention that the statutes herein involved are unconstitutional as affecting interstate commerce.

## II

However, *Benjamin* also made it clear that the McCarran Act did not insulate state legislation from attack on grounds other than the commerce clause. In that connection, the Supreme Court said (at p. 430):

"Nor is it necessary to conclude that Congress, by en-

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[3] See, for example: *Prudential Ins. Co.* v. *Hobbs* (1946) 328 U.S. 822.

acting the McCarran Act, sought to validate every existing state regulation or tax. For in all that mass of [state] legislation must have lain some provisions which may have been subject to serious question on the score of other constitutional limitations in addition to commerce clause objections arising in the dormancy of Congress' power. And we agree . . . that there can be no inference that Congress intended to circumvent constitutional limitations on its own power."

Thus we turn to plaintiff's alternative contention, i.e., that the retaliatory taxes violate the due process and equal protection clauses of the Fourteenth Amendment.[4]

We note first that, after the cautionary statement above quoted, the Supreme Court turned to consideration of the contentions that the retaliatory tax there before it did violate some other constitutional restriction. It said (at pp. 437-438):

"These arguments may be summarily disposed of. As for the due process contention, it was settled by a long line of authorities prior to the *South-Eastern* decision, that the . . . provision of the Fourteenth Amendment, as well as that requiring equal protection of the laws, does not forbid the states to lay and collect such a [retaliatory] tax. . . ."

The equal protection contention has been fully considered and rejected by a previous decision in this state in *Atlantic Ins. Co.* v. *State Bd. of Equalization* (1967) 255 Cal.App.2d 1. Although that case involved the pre-1964 changes in the California Constitution, the decision dealt with both of the requirements of the provision as it then stood. After deciding that the Texas laws therein involved

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[4] Although the contention is stated as involving both provisions, the discussions in the briefs are limited to the equal protection contention. We discuss the problem in that light.

did discriminate against California insurers, the court discussed the issue of equal protection as related to the (second) comparative requirement. Relying in part on *Franklin Life Ins. Co.* v. *State Bd. of Equalization* (1965) 63 Cal.2d 222, it was held that the comparative retaliatory tax did not violate the equal protection clause. Whether or not the court in *Atlantic* properly relied on *Franklin,* the decision was a square holding as to the equal protection issue, and not dictum, as we have said above, the pre-1964 California law required that *both* elements of the then constitutional provision be met before a retaliatory tax could be assessed. The Supreme Court denied hearing in *Atlantic.* Right or wrong, we feel impelled to follow it in the case before us. It follows that, like the commerce clause contention, the equal protection contention must also fail.

## III

The second major issue raised by this appeal relates to the calculation of the head office tax deduction.[5] That issue has, so far as we can discover, never been litigated in any earlier California case.

The Board argues that the effect of increasing the home office exemption to plaintiff would merely increase, pro tanto, the retaliatory tax payable for that year. Since the amount of the retaliatory tax is the difference between the premium tax paid to California and the comparable tax payable in plaintiff's home state, that contention is correct. It follows that, even if plaintiff is correct in its attack on the constitutionality of the home office exemption, the amount that it paid was correct. Plaintiff's argument here seeks to avoid that result by treating the gross pre-

[5] The entire home office deduction was repealed in 1976.

mium tax and the retaliatory tax as separate and arguing that, if it has overpaid the former and underpaid the latter, it is entitled to a refund on its timely claim for overpaid premium tax and the state is barred by section 12342 of the Revenue and Taxation Code from making a late assessment for underpaid retaliatory tax. This theory misses the reality of the California tax on insurers. The two provisions are but parts of a single taxation scheme. Unless plaintiff has, in the end, paid no more than the scheme required, it is not entitled to any refund.

The judgment is reversed.

*CERTIFIED FOR PUBLICATION.*

KINGSLEY, J.

We concur:

FILES, P.J.
ALARCON, J.

CERTIFIED FOR PUBLICATION

---

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FOUR

---

2 Civ. No. 55251
(Super Ct. No. C-3189)

---

THE WESTERN AND SOUTHERN
LIFE INSURANCE COMPANY,
Plaintiff and Respondent,

v.

STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA,
Defendant and Appellant.

---

**ORDER MODIFYING OPINION AND DENYING REHEARING**

(Filed November 28, 1979)

THE COURT:*

(1) The opinion heretofore filed in the above entitled case on November 3, 1979, is hereby modified as follows:

(a) In line 10 on page 10 of the Xerox opinion, [line 20, page 32a, herein] delete the word "retaliatory."

---

* FILES, P. J.; KINGSLEY, J.

(b) In footnote 3 on page 9 of the Xerox opinion [page 31a, herein] add the following: The tax involved in *Hobbs* has been held to be "substantially identical to Insurance Code section 685." (*Atlantic Ins. Co.* v. *State Board of Equalization* (1967) 255 Cal.App.2d 1, 10.)

(c) In line 13 on page 13 of the Xerox opinion, [line 21, page 34a herein] delete the word "no."

(2) The petition for rehearing is denied.

---

CLERK'S OFFICE, SUPREME COURT
4250 STATE BUILDING
San Francisco, California 94102

Dec. 27, 1979

I have this day filed Order

HEARING DENIED

In re: 2 Civ. No. 55251

Western and Southern Life Ins. Co.

vs.

State Board of Equalization

Respectfully,

G. E. BISHEL
Clerk

Supreme Court, U. S.
FILED
APR 11 1980
MICHAEL RODAK, JR., CLERK

# In the Supreme Court of the United States

OCTOBER TERM, 1979

**No. 79-1423**

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,
*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
*Appellee.*

## Motion to Dismiss or Affirm

On Appeal from the Court of Appeal, Second Appellate District, State of California

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# In the Supreme Court of the United States

OCTOBER TERM, 1979

**No. 79-1423**

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,
*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
*Appellee.*

## Motion to Dismiss or Affirm

On Appeal from the Court of Appeal,
Second Appellate District, State of California

Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, hereby moves this Court to dismiss this appeal or to affirm the decision of the California Court of Appeal for the following reasons:

1. This case does not present a substantial federal question.
2. This Court has no jurisdiction to consider the constitutional validity of the California principal office deduction because decision on that issue was rendered unnecessary on the basis of an adequate and independent state ground.

## INTRODUCTORY STATEMENT

This case involves the California tax provisions regarding insurance companies doing insurance business in California, including the California retaliatory tax for the years 1965 through 1971 (Cal. Const., art. XIII, former § 14-4/5, subd. f(3) and Cal. Ins. Code §§ 685-685.4) and the principal office deduction from the California gross premiums tax for the years 1967 through 1971 (Cal. Const., art. XIII, former § 14-4/5, subd. (e); former Cal. Rev. & Tax. Code § 12241).[1] The California retaliatory tax provisions can be summarized as providing that when a foreign state would impose a heavier tax burden upon a California insurer than California would normally impose upon a similar insurer from that foreign state, then California will instead impose the same tax burden on that state's insurer as would be imposed by that state upon the similar California insurer. This is what is known as a "comparative" retaliatory tax; all of the 49 states which have retaliatory insurance taxes have "comparative" statutes. See *infra* at p. 11 n. 9 and Appendix B hereto.

Before a 1964 amendment to the California constitutional provision, the California Constitution (but not the statute) had provided as an additional condition for the application of the retaliatory tax that the foreign state would actively discriminate by imposing upon the California insurer burdens exceeding those which it imposed upon its similar domestic insurer. The 1964 amendment to the California Constitution eliminated the internal discrimination condition without changing the "comparative" element of the retaliatory tax. *Franklin Life Ins. Co. v. State Board of*

1. See Appendix A for the text of the cited provisions.

*Equalization* (1965) 63 Cal. 2d 222, 227, 404 P.2d 477, 481; *Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 10, 62 Cal. Rptr. 784, 790 (hearing denied, Cal. Sup. Ct.); *Western & Southern Life Ins. Co. v. State Bd. of Equalization* (1970) 4 Cal. App.3d 21, 33, 84 Cal. Rptr. 88, 96 (hearing denied, Cal. Sup. Ct.).

In making the comparison required by the retaliatory provisions, California will transfer the California facts pertaining to the foreign insurer being taxed by California to a hypothetical California insurer in that foreign insurer's home state. Thus in determining appellant Western and Southern Life Insurance Company's (hereinafter "Western and Southern") retaliatory tax liabilities for each year in the case at bar, appellee State Board of Equalization (hereinafter "the Board") first determined the insurance premiums taxes and fees which Ohio (Western and Southern's home state) would have imposed on a similar California insurer transacting the same kind and amount of insurance business in Ohio that Western and Southern actually transacted in California. Since the resulting Ohio figures were greater than the premiums taxes and fees owed by Western and Southern to California, the difference between those amounts was imposed as the California retaliatory tax under the terms of Insurance Code section 685 and California Constitution, article XIII, section 14-4/5, subdivision (f)(3) as amended in 1964.

California also imposes a gross premiums tax upon all insurers doing business in California; this is a privilege tax measured by the amount of gross premiums, less return premiums, received during the year by the insurer from its California business. During the years at issue said tax had a principal office deduction whereby an insurer could deduct from the premiums tax otherwise due the amount of certain real estate taxes which it had paid during the year

upon real property containing its California principal office. Cal. Const., art. XIII, former § 14-4/5, subd.(e) as amended in 1966; Cal. Rev. & Tax Code § 12241 as amended in 1967.[2] Western and Southern has challenged the constitutional validity of the principal office deduction for the years in issue on the basis of a distinction made therein between some California insurers and other insurers.

In the decision which is on appeal[3] the California Court of Appeal held that the California comparative retaliatory tax is constitutionally valid. Jurisdictional Statement (hereinafter "J. S.") Appendix 30a-33a. It further held that it did not need to reach the federal constitutional issues regarding the principal office deduction, for under California law the gross premiums tax and the retaliatory tax "are but parts of a single taxation scheme," wherein no tax refund is due unless the taxpayer has paid more than the total scheme required. J. S. App. 34a, 36a. Since the burden which Ohio would impose upon a similar California insurer would be greater than California's nonretaliatory tax burden on Western and Southern, any gross premiums tax reduction Western and Southern might gain on its principal office deduction issue would be offset automatically under California law by an increase in its retaliatory tax liabilities. *Id.* Because of this result under California law the Court of Appeal did not decide the principal office deduction issues raised by Western and Southern.

On December 27, 1979, the California Supreme Court denied Western and Southern's request for hearing in this case. J. S. App. 36a.

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2. See Appendix A for the text of the cited provisions. The entire principal office deduction was repealed in 1976.

3. The Court of Appeal's decision is reported at 99 Cal.App.3d 410 (as modified), 159 Cal. Rptr. 539 (not as modified); references herein are to Appendix A of the Jurisdictional Statement.

## QUESTIONS PRESENTED

1. Is there a substantial federal question of whether the California comparative retaliatory insurance tax, which was enacted to secure uniformity and reciprocity among the states and which separately classifies each insurer by imposing upon said insurer the same higher tax burden as that insurer's home state would impose upon a similar California insurer, violates the commerce clause or the equal protection or due process guarantees of the United States Constitution?

2. Does the California holding that under California law the gross premiums tax and the retaliatory tax are but interrelated parts of a single insurance taxation scheme, and that any increase to Western and Southern's gross premiums tax principal office deduction would automatically be balanced by an increase in its retaliatory tax liability, provide an adequate state ground which prevents this Court from having jurisdiction to consider Western and Southern's challenge of the validity of the gross premiums tax principal office deduction?

## ARGUMENT

### 1. In Prudential Insurance Co. v. Hobbs This Court Upheld a Kansas Comparative Retaliatory Tax Which the California Courts Have Correctly Recognized As Being "Substantially Identical" to the California Comparative Tax Challenged Herein.

Western and Southern is clearly wrong in its claim, made in the face of *Prudential Insurance Co. v. Hobbs* (1946) 328 U.S. 822, that this Court "has never considered the validity of comparative retaliatory taxes." J.S. 15. The comparative retaliatory tax which was in issue in *Prudential Insurance Co. v. Hobbs* has previously been recognized as being "substantially identical to [California] Insurance Code section 685" (*Atlantic Ins. Co. v. State Board of*

*Equalization* (1967) 255 Cal.App.2d 1, 10, 62 Cal. Rptr. 784, 790), which is the precise statutory provision which has been applied (under the consistent California constitutional provision as amended in 1964) in the present case.

*Hobbs* involved several Kansas insurance taxes; one of the taxes involved was the Kansas retaliatory tax which was a purely "comparative" tax in that it required as a condition for its application that the foreign state impose a higher basic tax burden on Kansas insurers than Kansas imposed on that state's insurers, but it did not require that the other state have any internal domestic/foreign discrimination within its own laws to trigger the application of the Kansas retaliatory tax.[4]

Thus *Hobbs* did involve a state retaliatory insurance tax provision "substantially identical" to the California retaliatory tax as it exists at the present time and which the California Court of Appeal, citing *Hobbs* (J.S. 31a, 36a), has found to be constitutional. The Kansas Supreme Court in *Hobbs* found this retaliatory tax (and the other Kansas insurance taxes) to not be in violation of the commerce clause of the United States Constitution. *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 P.2d 726, 730, 735. This United States Supreme Court affirmed that holding in a *per curiam* decision, citing *Prudential Insurance Co. v. Benjamin* (1946) 328 U.S. 408. *Prudential Insurance Co. v. Hobbs* (1946) 328 U.S. 822. The *Benjamin* case considered the McCarran Act's provision (59 Stats. 33, 34

4. ". . . G.S. 1935, 40-253 provides that when the laws of a state under which the insurance company was incorporated require the payment of greater taxes, etc. from insurance companies of other states than is required by the existing laws of this state, then such companies shall pay the taxes, etc. which would be required by a company organized in this state in order to do business in such other state." *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 P.2d 726, 730, *aff'd. per curiam sub nom. Prudential Insurance Co. v. Hobbs* (1946) 328 U.S. 822.

(§ 2(a)), 15 U.S.C. § 1012) that "the business of insurance . . . shall be subject to the laws of the several states which relate to the regulation or taxation of such business"; this Court concluded that Congress had "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause to whatever extent this may be done" (328 U.S. 408, 431) and held that Congress had the power to release all state taxation of insurance business from commerce clause restraints. *Id.* at 427, 433-36.[5]

Appellant Western and Southern hopes to convince this Court to join the trial court (see J.S. 14-15) in the erroneous view that *Hobbs* did not involve a comparative retaliatory tax similar to the one at issue in this case. But appellant's error is transparent: on page 5 of the Jurisdictional Statement Western and Southern states that a retaliatory tax is an "anti-discrimination retaliatory tax" if it is conditioned upon the foreign state actually discriminating in its laws in favor of its domestic insurers and against all others; on page 13 of the Jurisdictional Statement Western and Southern flatly states that *Hobbs* "involved not a *comparative* retaliatory tax but an *anti-discrimination* retaliatory tax" without citing any part of the Kansas statute which stated any condition that would have brought the statute within the category fashioned by Western and Southern itself. As shown above, the Kansas statute included no such condition; it was purely a comparative retaliatory insurance tax statute which Kansas found to be not discriminatory and

5. The subsequent decisions of this Court which are cited in the first incomplete paragraph on page 16 of the Jurisdictional Statement have no bearing on this case. They relate to the question of the scope of the meaning of the term "insurance business" as used in the McCurran Act; they do not affect in the slightest the Act's release from commerce clause restraints for state taxation of what is clearly insurance business.

which this Court upheld *per curiam* in *Prudential Insurance Co. v. Hobbs* (1946) 328 U.S. 822.

## II. Other Case Authority Fully Supports the Validity of the Comparative Retaliatory Tax.

The California Supreme Court has earlier held, under the decision of this United States Supreme Court in *Prudential Insurance Co. v. Benjamin* (1946) 328 U.S. 408, that retaliatory insurance tax statutes cannot be challenged on the ground of violation of the commerce clause of the United States Constitution. *Franklin Life Ins. Co. v. State Board of Equalization* (1965) 63 Cal.2d 222, 225 n. 2, 404 P.2d 477, 480 n. 2. This holding results from the federal McCarran Act (15 U.S.C. §§ 1011-1015) which, as the *Benjamin* case established, removed all commerce clause restrictions from the transaction of interstate insurance business. *Id.; also see Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 11-12, 62 Cal. Rptr. 784, 791.[6]

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6. The trial court in the present case quoted a statement from the *Atlantic* decision out of context in such a manner as to imply that *Atlantic* had concluded that a purely comparative retaliatory tax would violate federal constitutional guarantees. Western and Southern has quoted the trial court's misleading discussion on page 15 of the Jurisdictional Statement. When the *Atlantic* statement is placed in context, it is clear that the California Court of Appeal was speaking of the violation of the pre-1964 California Constitution which would have occurred if the purely comparative California statute had been applied in instances where there was no satisfaction of the additional condition of foreign-state discrimination which was required by the pre-1964 retaliatory tax provision of the California Constitution. *Atlantic Ins. Co. v. State Bd. of Equalization* (1967) 255 Cal.App.2d 1, 5-6, 62 Cal. Rptr. 784, 787. In 1970 the California Court of Appeal, citing *Atlantic* as support, concluded (in what technically was dicta) that the very insurer involved in this case would not suffer infringement of its federal constitutional rights under the purely comparative retaliatory provisions of the post-1964 California Constitution. *Western & Southern Life Ins. Co. v. State Bd. of Equalization* (1970) 4 Cal.App.3d 21, 30, 84 Cal. Rptr. 88, 94.

The McCarran Act did not and could not dispense with the due process and equal protection rights of insurers; the California *Franklin* decision also dealt with these constitutional guarantees. In addition to its commerce clause holding, the *Franklin* opinion also holds that California law does not violate said federal due process and equal protection guarantees when it distinguishes between tax treatment of non-California insurers on the basis of whether their home states would apply a heavier tax burden upon a similar California company doing business there. 63 Cal.2d at 232-33, 404 P.2d at 484-85.

Although for the pre-1964 period involved in *Franklin* the California retaliatory tax was conditioned on discrimination by the other state in addition to the standard comparative test, in *Franklin* the taxpayer's equal protection argument was based solely on the effect of application of the "comparative" element that compares the result under California law with the result under the other state's law. The taxpayer argued in *Franklin* that it was deprived of equal protection because large Illinois insurers would not have to pay any California retaliatory taxes while small Illinois insurers with similar California principal offices, such as Franklin Life, would.[7] Thus the California Supreme

7. Illinois Insurance Code section 409 (Smith-Hurd Ill. Ann. Stat., ch. 73, § 1021) levies, and at the time of the *Franklin* facts levied, upon all non-Illinois insurers a privilege tax measured by 2 percent of premiums. This tax did not apply to Illinois insurance companies, and there was no distinction in Illinois law between the methods of taxing large and small insurers. Although the California gross premiums tax rate was more than that of the Illinois tax, application of the California principal office deduction to the small Illinois insurer in *Franklin* resulted in the basic California burden on that insurer being less than the burden which the Illinois statute would impose upon a similar California insurer. 63 Cal.2d at 231-32, 404 P.2d at 484-85. Thus the California retaliatory tax applied in *Franklin*. A large Illinois insurer with more gross premiums but with the same size principal office deduction could have a total

Court in *Franklin,* applying the "rational basis" standard set by this Court in *Carmichael v. Southern Coal Co.* (1937) 301 U.S. 495, 509, necessarily concluded as a part of its holding that it was reasonable under the federal due process and equal protection standards for California to distinguish in its tax treatment of non-California insurance companies on the basis of whether their home state would have applied a heavier tax burden upon a similar California company doing business there. *Id.* at 232-33, 404 P.2d at 485. Due to the California principal office deduction, in *Franklin* that classification rendered different results as between large and small insurance companies from the same state with principal offices in California; that classification test also renders different results as between insurance companies from different states, depending on the individual characteristics of the insurer involved and the tax burdens which its home state would impose upon a similar California insurer.

As pointed out by the California Court of Appeal (J. S. App. 30a), the purpose of retaliatory taxes is to put pressure on the several states to impose the same tax burden on all insurance companies and thereby encourage the doing of interstate business. As phrased in the *Atlantic* case, 255 Cal.App.2d at 15, 62 Cal. Rptr. at 793, retaliatory insurance tax laws are enacted to "secure reciprocity" and "to achieve uniformity of treatment and not to discriminate." As shown by the *Franklin* decision, *supra,* comparative retaliatory tests do not classify all out-of-state insurers together and impose greater burdens upon such insurers

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California tax burden equal to or greater than the burden Illinois would impose upon a similar California insurer, with the result that such an insurer would not be subject to the California retaliatory tax.

as a group;[8] rather, each such comparative statute separately classifies each insurer by the way that insurer's home state would treat a similar insurer from the state having the comparative retaliatory statute. Comparative retaliatory provisions of other states[9] have been upheld as utilizing a reasonable basis of classification. *See Phoenix Ins. Co. v. Welch* (1883) 29 Kan. 672, 32 Pac. States Rep. 480, 482, 484-85; *Commonwealth v. Fireman's Fund Ins. Co.* (1952) 369 Pa. 560, 87 A.2d 255, 258; *Baldwin v. Insurance Co. North America* (1888) 115 Ind. 257, 17 N.E. 574, 579.

**III. The California Courts Have Determined Solely on the Basis of California Law That, Given the Validity, Application and Function of the Retaliatory Tax As One Part of a Consolidated Scheme of California Insurance Taxation, It Is Unnecessary to Decide Western and Southern's Challenge of the Validity of the Gross Premiums Tax Principal Office Deduction; This Is an Adequate State Ground That Results in There Being No Jurisdiction in This Court to Decide the Federal Issue Which Was Not Reached by the California Decision.**

On pages 5, 6-7 and 12 of the Jurisdictional Statement, Western and Southern touches upon the issue involving the 1966 amendment to the principal office deduction provided (until the deduction's 1976 repeal) for the California gross premiums tax. As the Court of Appeal has held in the instant case (J.S. App. 33a-34a, 36a), once the constitutional

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8. This is one of the aspects of this case which distinguish it from cases such as *Wheeling Steel Corporation v. Glander* (1949) 337 U.S. 562, *Reserve Life Insurance Co. v. Bowers* (1965) 380 U.S. 258 (per curiam), and *WHYY v. Glassboro* (1968) 393 U.S. 117 (per curiam), cited by Western and Southern on pages 16 and 17 of the Jurisdictional Statement.

9. Forty-nine of the fifty states currently have insurance retaliatory taxes; *all* of those taxes are of the purely "comparative" type such as the Kansas statute involved in *Hobbs* and the California provisions involved in the case at issue. See Appendix B for a listing of said retaliatory tax statutes.

validity of the California retaliatory tax has been established, there is no need to determine the constitutional validity of the 1966 principal office deduction amendment on the merits, for the holding that the retaliatory tax is valid fully determines that Western and Southern is not entitled to any judgment on its suit for tax refund: any lowering of Western and Southern's California premiums tax liabilities for each year would result under California law in an identical increase in the retaliatory tax amount, so that Western and Southern's liabilities under the two taxes would still total the same as the total insurance tax liability an identical California insurer would incur in Ohio, Western and Southern's home state.[10] This outcome under the retaliatory tax results from the fact that Ohio imposed or would have imposed a greater tax burden on a similar California insurer than California imposed on Western and Southern for the years involved.

The California holding in this case, that as a matter of California law the retaliatory tax and the gross premiums tax "are but parts of a single taxation scheme" wherein no refund is due unless the taxpayer has paid more than the entire scheme required (J.S. App. 34a, 36a), is a construction of the California statutes and constitutional provisions which is binding upon this Court. *See Hebert v. Louisiana* (1926) 272 U.S. 312, 316. Furthermore, the California resolution of the principal office deduction issue on this basis constitutes an adequate state ground independent of the federal issue, not decided by the Court of Appeal, of whether the post-1966 principal office deduction to the Cali-

10. Although Western and Southern relies heavily upon the trial court's opinions in other respects, appellant fails to mention that the trial court reached the same conclusion in the minute order it issued with its memorandum of intended decision. J.S. App. 2a.

fornia gross premiums tax taken by itself would have violated the constitutional rights of a foreign insurer. Given the presence of such an adequate independent state ground in the case at bar, this Court has no jurisdiction in this case over the issue of the constitutional validity of the post-1966 principal office deduction. *Herb v. Pitcairn* (1945) 324 U.S. 117, 123-24, 125-26.

Even if there were not an adequate state ground resolving the principal office deduction issue, Western and Southern would not be entitled to any relief. The gross premiums tax is a privilege tax, not a property tax. *Carpenter v. Peoples Mutual Life Ins. Co.* (1937) 10 Cal.2d 299, 74 P.2d 508. This Court has made it clear that, absent the special facts of *Southern Railway Co. v. Greene* (1910) 216 U.S. 400 (corporation with immense investments in property irretrievably devoted to a limited and monopolistic use), a state may constitutionally impose new *privilege* tax burdens on foreign corporations already doing business in the state without imposing equivalent burdens on domestic corporations. *Cheney Brothers Co. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Baltic Mining Co. v. Massachusetts* (1913) 231 U.S. 68, 87-88; *Northwestern Life Ins. Co. v. Wisconsin* (1918) 247 U.S. 132, 139-40; *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494, 510-12, 514-15.

## CONCLUSION

For the reasons set forth above, it is respectfully submitted that this Court should dismiss the appeal or, in the alternative, affirm the decision of the California Court of Appeal.

DATED: April 9, 1980

Respectfully submitted,

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**(Appendices Follow)**

## *Appendix A*

Article XIII, section 14-4/5, subdivision (f)(3), as amended in 1964 and as it was in effect for the years 1965 through 1971, provided as follows:

> (3) When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this state; so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this paragraph (3) of subdivision (f).
>
> The provisions of this paragraph (3) of subdivision (f) shall not apply as to personal income taxes, nor as

to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this paragraph (3) of subdivision (f).

For the purposes of this paragraph (3) of subdivision (f) the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States.

In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

The provisions of this paragraph (3) of subdivision (f) shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.

California Insurance Code section 685 through 685.4, as enacted in 1959, and as they have existed without change ever since, provide as follows:

§ 685.

When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives

of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this State, so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this article.

§ 685.1.

This article shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this article.

§ 685.2.

For the purposes of this article the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States.

In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

§ 685.3.

To the extent permitted by the Constitution of this State there is hereby imposed upon the commissioner the duty of enforcing the execution of the provisions of Section 685. It shall be the duty of the commissioner to initiate the enforcement and execution of the provisions of Section 685 in request to all matters which by the Constitution or laws of this State require further or final action by other officials of this State. In respect to any matter initiated by the commissioner, it shall be the duty of the Board of Equalization, Board of Control and State Controller to complete the enforcement and execution of the provisions of Section 685 in respect to such matter within the scope of the duties and powers of each as set forth in the Constitution and laws of this State.

§ 685.4.

The provisions of this article shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.

Article XIII, section 14-4/5, subdivision (e), as amended in 1964 and as it was in effect for the years 1967 through 1971, provided as follows:

(e) (1) Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

(2) In the event a portion of the real property described in paragraph (1) of this subdivision is occupied by a person or persons other than the insurer the deduction granted the insurer by said paragraph shall be limited to that percentage, not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this paragraph, "domestic insurer" means an in-

surer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(3) The phrase "person or persons other than the insurer" as used in paragraph (2) of this subdivision shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities. The Legislature may define the terms used in this paragraph for the sole purpose of facilitating the operation of this paragraph.

California Revenue and Taxation Code section 12241, as amended in 1967 and as it was in effect for the years 1967 through 1971, provided as follows:

§ 12241.

(a) Each insurer shall have the right to deduct from the tax imposed by this chapter upon an insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

(b) In the event a portion of the real property de scribed in subdivision (a) is occupied by a person or persons other than the insurer the deduction granted

the insurer by said subdivision shall be limited to that percentage not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this section, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(c) The phrase "person or persons other than the insurer" as used in subdivision (b) of this section shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities.

## *Appendix B*

The following are all the state statutes which impose a retaliatory tax; all 49 are "comparative" retaliatory statutes:

Code of Ala. 1975 § 27-3-29 (1977); Alaska Stat. § 21.09.270 (1966); Ariz. Rev. Stat. § 20-230 (1977); Ark. Stat. § 66-2225 (1961); Cal. Ins. Code §§ 685-685.4 (1959); Colo. Rev. Stat. 1973 § 10-3-209(2) (1973); Conn. Gen. Stat. § 12-211 (1965); Del. Code Ann. tit. 18, § 531 (1953); Fla. Stat. Ann. § 624.429 (1969); Ga. Code Ann. § 56-321 (1960); Idaho Code § 41-340 (1961); Ill. Ins. Code § 444 (Smith Hurd Ill. Ann. Stat. ch. 73, § 1056) (1941); Indiana Code § 27-1-20-12 (1937); Iowa Code Ann. § 505.14 (1955); Kan. Stat. Ann. § 40-253 (1967); Ky. Rev. Stat. Ann. § 304.3-270 (1970); La. Rev. Stat. § 22:1079 (1970); Me. Rev. Stat. Ann. § 24-A-428 (1973); Md. Ann. Code art. 48A, § 61 (1971); Mass. Ann. Laws ch. 175, § 159 (1922); Mich. Stat. Ann. § 24.1476 (1948); Minn. Stats. Ann. § 60A.19, subd. 6 (1971); Miss. Code §§ 27-15-121 through 27-15-127 (1964); Mo. Ann. Stat. § 375.916 (1967); Mont. Rev. Code § 40-2826 (1959); Neb. Rev. Stat. § 44-150 (1959); Nev. Rev. Stat. § 68A.330 (1971); N. H. Rev. Stat. § 400-A:35 (1971); N.J. Stat. Ann. § 17:32-15 (1950), § 17B:23-5 (1971); N.M. Stat. § 58-5-27 (1951) (insurance brokers), § 58-5-49 (1951) (insurance agents); N.Y. Ins. Law § 61 (1973); N.C. Gen. Stat. § 58-152 (1945); N.D. Century Code § 26-01-05 (1943); Ohio Rev. Code Ann. § 3905.41 (1953), § 5729.06 (1953); Okla. Stat. Ann. tit. 36, § 628 (1957); Ore. Rev. Stat. § 731.854 (1967); 40 Pa. Cons. Stat. Ann. § 50 (1974); R.I. Gen. Laws § 27-2-17 (1956); Code of Laws of S.C. § 37-132 (1972); S.D. Cod. Laws § 58-6-70 (1978);

Tenn. Code Ann. § 56-241 (1955); Vernon's Ann. Texas Stat., Ins. Code art. 21.46 (1957); Utah. Code Ann. 31-14-19 (1963); Vt. Stat. Ann. tit. 8, § 3367 (1967); Va. Code § 38.1-87 (1952); Wash. Rev. Code Ann. § 48.14.040 (1947); W. Va. Code Ann. § 33-3-16 (1957); Wis. Stat. Ann. § 76.35 (1921), § 76.36 (1975); Wyo. Stat. § 26.1-77 (1967).

The years given with the above citations show the date of enactment or date of most recent amendment or reenactment.

Supreme Court, U. S.
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IN THE

# SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79-1423

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the Court of Appeal, Second Appellate District, State of California

## APPELLANT'S BRIEF IN OPPOSITION TO APPELLEE'S MOTION TO DISMISS OR AFFIRM

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## INTRODUCTION

Appellant, The Western and Southern Life Insurance Company, hereby submits its brief in opposition to Appellee's Motion to Dismiss or Affirm (hereinafter Motion).

## ARGUMENT

Contrary to Appellee's contention, (Motion, p. 5), this Court did not consider the validity of comparative retaliatory taxes in *Prudential Insurance Company* v. *Hobbs,* 328 U.S. 822 (1946). *Hobbs* involved three Kansas taxes imposed on the foreign insurer: a firemen's relief fund tax, a premiums tax, and the retaliatory tax in G.S. 1935, 40-253, correctly quoted on page 6 of Appellee's Motion.

However, the sole contention made in the Kansas Supreme Court in respect to each was that the commerce clause was violated and that *United States* v. *South-Eastern Underwriters Association,* 322 U.S. 533 (1944), rendered prior decisions "obsolete." *In re Insurance Tax Cases,* 161 P.2d 726, 731 (1945). The Kansas Supreme Court carefully pointed out that the Kansas taxes had been a part of Kansas law *since 1871, Id.* at 730, and significantly declared:

> When each of the plaintiffs *was admitted to do business* in this state it either specifically or in legal effect agreed to be bound by the laws of the state respecting its business.

*Id.* at 733 (emphasis supplied). The Court meticulously footnoted the date of admission of each of the sixteen insurers involved and which of them were affected by the retaliatory tax. *Id.* at 728. Not a single one so affected was admitted in Kansas *until long after the crucial 1871 date.*

The Kansas Supreme Court provided its own syllabus of its decision, as follows:

1. Our statutes pertaining to insurance, G.S. 1935, 40-252, subd. B, 40-253, 40-170, and G.S. 1943 Supp. 40-1702 and 40-1703 were not rendered void by the decision of the Supreme Court of the United States in United States v. Southeastern Underwriters Ass'n, 322 U.S. 534, 64 S. Ct. 1162, 88 L.Ed. 1440.
2. Congress did not exceed its powers in passing Public Law No. 15 of the 79th Congress, first session, 15 U.S.C.A. § 1011 et seq.
3. Mandamus will not be allowed to compel an executive officer to do something contrary to a statute unless it is clear that the statute is void.

The memorandum opinion of this Court could do no more than affirm the foregoing propositions of law. In affirming, this Court relied upon its decision of a week earlier in *Prudential* v. *Benjamin,* 328 U.S. 408 (1946), which had been written with the *Hobbs* case in mind. Significantly, in *Benjamin* this Court had cautioned:

> We express no opinion concerning the validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein.

*Id.* at 431, n. 40. This expressly excluded approval of the retaliatory tax feature in *Hobbs,* for it was not a feature of the South Carolina tax. The retaliatory tax was necessarily removed from consideration in *Hobbs* because it had been *imposed as a condition for the admission* of the insurers in Kansas.

The case involved proceedings in mandamus originally instituted by sixteen insurance companies (later joined by six others) to compel the Commissioner of Insurance to issue them certificates of authority to do business in Kansas in 1945 without payment on their part of the premium taxes on their 1944 business or of fireman's relief fund taxes. They based their action on the claim that *South-Eastern Underwriters* rendered void all state regulation and taxation of insurance companies engaged in interstate commerce. The Kansas Supreme Court denied the writs, finding that the *South-Eastern Underwriters* decision did not pass upon the validity of any state law regulating or taxing insurance companies. Nor did the Supreme Court of Kansas find that there was any discrimination against foreign as compared to domestic insurance companies. The Court said:

> It is true that domestic insurance companies are taxed on a different basis. They are not required

> to pay a tax measured by their premiums but they are required to pay a capital stock tax . . . and a tax upon the net value of their assets . . . . The fact that the tax on domestic companies is upon a different basis than that upon foreign companies does not of itself render the tax invalid . . . . We are unable to find in the record evidence to support the view that the tax in question upon foreign insurance companies is greater than that levied on the home insurance companies. More than that, the counter abstract of the defendant clearly demonstrates that the foreign insurance companies have not been handicapped in transacting their state business in Kansas by reason of any differences in the methods of taxation.

*In re Insurance Tax Cases,* 161 P. 2d at 734.

The language of the Kansas Supreme Court is far different from that of the Los Angeles County Superior Court in the instant case, which found such discrimination and handicap to exist, and indeed found that Western and Southern Life Insurance Company has been required to pay $977,853.57 more in taxes to California than it would have had it been a California company.

Appellee correctly states that in the case of *Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408 (1946), this Court concluded that Congress had "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause *"to whatever extent this may be done."* The question remains, what is the extent of Congess' power. Can Congress grant power to the states to legislate discriminatorily? Does Congress have the power itself to classify for tax purposes purely on the basis of residence? If Congress can not itself under the constitution discriminate between taxpayers engaged in interstate commerce based on unreasonable classifications, can it nevertheless grant states the power to do so? Appel-

lant submits that the answer to each of these questions is "No."

The Board states in its Motion that 49 of the 50 states currently have insurance retaliatory taxes and that

> "*all* of those taxes are of the purely 'comparative' type such as the Kansas statute involved in *Hobbs* and the California provisions involved in the case at issue". Motion, page 11 n. 9.

These statements are clearly erroneous. No such taxes upon foreign insurance companies exist in New Mexico, North Carolina and Hawaii. Further the Board's statement that *all* taxes are "purely comparative" is also erroneous. For example, the Florida retaliatory provision, Fla. Stat. Ann § 624.429 (3) (b) (1969) provides that a foreign insurer which maintains a regional home office in the state "shall not be subject to retaliation as it relates to premium tax." North Carolina eschews retaliatory laws all together, as follows:

> "No fees or taxes imposed in this article shall be increased on account of any retaliatory law [in § 58-152, Gen. Stats. 1943] now in effect in this or any other state, but such fees and taxes shall apply to all insurance companies alike, as specified in this article, without regard to state, territory or country of domicile or location of home office, and without regard to any fees or taxes which may be levied by any jurisdiction in which any company may be domiciled or have its home office."

N.C. General Stat. § 105-228.8.

If the practice of retaliatory taxation of insurance companies is widespread, this only magnifies the substantiality of the issues involved herein. The fact that so many states have adopted a discriminatory measure does not change the Constitution of the United States.

The alleged purpose of the retaliatory tax statutes is to:

> "aid in the protection of insurers formed under the laws of [this state] and transacting insurance in other states . . . against discriminatory or onerous requirements under the laws of such states . . . ."

See, e.g., Code of Ala. 1975 § 27-3-29 (1) (1977); Ky. Rev. Stat. Ann. § 304.3-270 (1) (1970).

The Appellee at p. 10 of its Motion repeats a statement by the California Court of Appeal in *Atlantic Insurance* v. *State Board of Equalization,* 255 Cal. App. 2d 1 (1967), that the purposes of retaliatory insurance tax laws are to "secure reciprocity" and "to achieve uniformity of treatment and not to discriminate." The assumption upon which this statement rests is that insurance companies in states with higher tax rates are somehow responsible for those rates. This is patently absurd, both as to the notion of control of the legislature by insurance companies and the hypothesis that any insurance company wants higher tax rates, whether in the domiciliary or another state.

Retaliatory taxation of insurance companies has been recognized as perpetuating an unsatisfactory form of gross receipts tax. Pyle, The Metamorphic Retaliatory Tax Law (What Lies Ahead?), XXII Association of Life Insurance Counsel Proceedings, (1971-72), p. 857. The National Association of Insurance Commissioners at its Annual Convention adopted on December 17, 1970, the following policy statement:

> In summary, the task force finds the present system of premium taxation to be unfair and inappropriate to the contemporary insurance economy, and recommends, as a single and indivisible program, the elimination of premium tax discrimination between domestic and foreign companies, the elimination of pre-

mium tax discrimination among types of insurance organization or arrangement, the elimination of retaliatory premium taxes.

Retaliatory taxation cannot accomplish its alleged purposes. The result is neither uniformity within a state, nor uniformity between states. It would be entirely possible under the existing California law for 49 insurance companies, each from one of the other 49 states, having the same assets, liabilities and mix of business, to be assessed 49 different tax amounts to do business in California, dependent solely on the laws of their respective domiciles. The Constitution of the United States does not permit such a result. Classification solely on the basis of domicile is invalid. *Western Union Telegraph Company* v. *Frear,* 216 F. 199 (W.D. Wis. 1914). The entire scheme of retaliatory taxation is misconceived, discriminatory, and doomed to its present unfortunate state unless this Court acts.

This Court after 76 years reversed *Paul* v. *Virginia,* 75 U.S. (8 Wall.) 168 (1868) and determined in *U.S.* v. *South-Eastern Underwriters Ass'n,* 322 U.S. 533 (1946) that insurance business was interstate commerce. If *Prudential* v. *Benjamin* and *Prudential* v. *Hobbs* are authority for the proposition that the discriminatory taxes levied by California and other states on foreign insurance companies are constitutional, it is time to reverse those decisions. If those cases are not authority for such proposition, Appellant urges this Court to take this opportunity to say so.

## CONCLUSION

Appellant repeats its belief that the constitutional questions involved in this case are so substantial as to warrant plenary consideration, with briefs on the merits and oral argument, for their resolution.

Respectfully submitted,

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*Appellee.*

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## Reply to Amicus Brief of United States

On Appeal from the Court of Appeal,
Second Appellate District, State of California

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### INTRODUCTORY STATEMENT

In response to the Court's invitation of May 12, 1980, the United States has filed a brief as *amicus curiae* in support of appellant, The Western and Southern Life Insurance Company (hereinafter "Western and Southern"). Although that brief deals with areas which have already been discussed in the Motion to Dismiss or Affirm (hereinafter cited as "Board's Motion") of appellee State Board of Equalization (hereinafter "the Board"), the United States' brief does so in such a manner as to give the impression that new ground is being broken. Therefore, reassertion of a few basic principles might be in order to clarify the issues.

## ARGUMENT

### 1. Congress Has the Power to Remove All Commerce Clause Restrictions on State Taxation of Insurance Companies; This Court Has Held In Prudential v. Benjamin that in the McCarran Act Congress Exercised that Power.

A reading of the brief of the United States leaves one with the impression that there can be a violation of the commerce clause even when Congress has attempted to exempt the states from all commerce clause restraint in the particular area involved, and that in the McCarran Act Congress did not make such an attempt as to the states' taxation of insurance business. However, any such impression is dispelled by an actual reading of Supreme Court decisions cited by the United States.

*Lewis v. BT Investment Managers, Inc.* (1980) .... U.S. ...., 48 U.S.L.W. 4638, is cited on pages 11 and 12 of the United States brief; yet the United States fails to note that *Lewis* is the most recent decision of this Court which recognizes that Congress may exempt whole areas of the law from commerce clause coverage:

> "Congress, of course, has power to regulate the flow of interstate commerce in ways that the States, acting independently, may not. And Congress, if it chooses, may exercise this power indirectly by conferring upon the States an ability to restrict the flow of interstate commerce that they would not otherwise enjoy. See *H. P. Hood & Sons, Inc. v. Du Mond,* 336 U. S., at 542-543; *Prudential Insurance Co. v. Benjamin,* 328 U.S. 408, 423-424 (1946); *International Shoe Co. v. Washington,* 326 U.S. 310, 315 (1945)." *Id.* at ....; 48 U.S.L.W. at 4643.

This Court's citing of *Prudential v. Benjamin* is notable, for in *Benjamin* this Court held that Congress had the power

to release all state taxation of insurance business from commerce clause restraints. 328 U.S. 408, 427, 433-36.

Once Congress' power is established, the only remaining commerce clause question in this matter is whether by the McCarran Act Congress fully exercised this power as to insurance taxation by the states. Again *Prudential v. Benjamin* provides unequivocal precedent. In the *Benjamin* case this Court considered the McCarran Act's provision (59 Stats. 33, 34 (§ 2(a)), 15 U.S.C. § 1012) that "the business of insurance . . . shall be subject to the laws of the several states which relate to the regulation *or taxation* of such business" (emphasis added); this Court held that Congress had "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause to whatever extent this may be done with the force of that power behind it, subject only to the exceptions expressly provided for." 328 U.S. 408, 431. There are no exceptions stated within the McCarran Act which would apply in the current case.[1]

Given these clear holdings, there is no point discussing authorities which have dealt with situations where Congress did not exercise its commerce clause exemption power to

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1. On pages 12 through 16 of the United States' brief *amicus* takes great pains to establish that the McCarran Act was only meant to reestablish what the state of the law had been before the decision in *United States v. South-Eastern Underwriters Ass'n* (1944) 322 U.S. 533. Such a proposition would not hurt the Board's position: *South-Eastern* recognized that for the previous seventy-five years this Court had held that the commerce clause did not affect state taxation of insurance business, based on the proposition that " 'the business of insurance is not commerce' ". *Id.* at 534, 543-44. The *Benjamin* decision notes that, before *South-Eastern*, the negative implications of the commerce clause had become irrelevant for the valid exercise of state taxing authority regarding the business of insurance, 328 U.S. at 416. Thus before *South-Eastern* there would have been no question under the commerce clause regarding the insurance taxation involved in this case.

the extent it did in the McCarran Act. Thus most of the cases cited on pages 10 through 12 of the United States' brief are simply inapplicable and need not be further analyzed here.

### 2. The Holding in Prudential v. Hobbs Directly Applies here to Uphold the Retaliatory Tax Against Attacks Made in the Name of the Commerce Clause.

As pointed out in the Board's motion (pp. 5-8), in *Prudential Insurance Co. v. Hobbs* (1946) 328 U.S. 822, this Court, in a *per curiam* decision citing the *Benjamin* case, affirmed a Kansas decision which upheld a comparative retaliatory insurance tax against a commerce clause attack. The United States' brief (p. 16) attempts to convince this Court that in 1946 this Court did not realize what it was doing when it made its *Hobbs* ruling. The Board believes that it is clear that this Court meant to do just what it did: to apply the principles of the *Benjamin* case involving the McCarran Act in upholding the validity of a comparative retaliatory tax[2] against an attack made in the name of the commerce clause.

### 3. There is no Substantial Equal Protection Question.

The United States attacks the California insurance retaliatory tax under the equal protection clause on the bases that Western and Southern had been granted a license of indefinite term before the California retaliatory tax was reimposed (U.S. Brief p. 8; see also Western and Southern's latest brief, p. 2) and that the tax supposedly was imposed upon Western and Southern merely "because it is a foreign

2. At least the United States does not join Western and Southern in taxpayer's desperate attempts (J.S. 14-15, Western and Southern's latest brief, pp. 2-4) to establish that the Kansas statute was somehow not the same type of retaliatory tax which is presently at issue. See Board's Motion pp. 6-8.

corporation." (U.S. Brief, p. 9; see also Western and Southern's latest brief, p. 7.) Neither of these alleged foundations are sound. As to the first, if the United States is aware that Western and Southern's certificate of authority to transact California insurance business is for an indefinite term, the United States must also know that this certificate states that such admission to do business is "expressly conditioned" upon conformance with the California laws then in effect *and* as they may thereafter "be changed or amended." This explicit condition destroys any arguments based on the indefinite term of Western and Southern's certificate of authority. *See Lincoln Life Ins. Co. v. Read* (1945) 325 U.S. 673, 676 (privilege tax imposed only on foreign states' insurance companies).

The California retaliatory insurance tax is not imposed upon Western and Southern solely because it is a foreign corporation. The United States' brief ignores the authorities cited on pages 9 through 11 of the Board's motion, which establish that the purpose of such retaliatory laws is not to discriminate but to encourage interstate insurance business by equalizing the insurance tax burdens of the various states and secure reciprocity and uniformity of treatment.[3] In doing so, comparative retaliatory statutes such as California's do not classify all out-of-state insurers together as the federal brief claims; instead, a comparative retaliatory tax statute such as California's separately classifies each insurer by the way that insurer's home state would

3. This purpose of encouraging the doing of interstate insurance business distinguishes this case from the United States' attempted analogy involving hypothetical general real property tax retaliation (U.S. Brief p. 9). Further, as noted in *Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 15, 62 Cal. Rptr. 784, the insurance tax rates of the various states are relatively uniform, thus indicating that the purpose of the retaliatory insurance statutes has been realized.

treat a similar insurer from the state having the retaliatory statute. See Board's Motion, pp. 9-11. As demonstrated by *Franklin Life Ins. Co. v. State Board of Equalization* (1965) 63 Cal.2d 222, 232-33, 404 P.2d 477-485 (discussed in Board's Motion pp. 9-10 and n. 7), such a comparative test does not even classify all insurers from the same state together; given the nature of the test in satisfying the intent behind the statutes, some insurers from one state may be subject to the tax while others from the same state are not.

The authorities presented by the United States to support its equal protection arguments are inapposite. *Toomer v. Witsell* (1948) 334 U.S. 385, 395-407 (cited U.S. Brief p. 9) explicitly eschews reliance upon the equal protection clause (*id.* at 403) in basing one of its holdings on the privileges and immunities clause; it is elementary that corporations such as Western and Southern are not "citizens" entitled to the protection of the privileges and immunities clause. *Asbury Hospital v. Cass County* (1945) 326 U.S. 207, 210-11; *Paul v. Virginia* (1868) 8 Wall. 168, 177. The other holding in the portions of *Toomer* cited by the United States concerned the commerce clause, with no mention of the equal protection clause. *A&P Tea Co. v. Cottrell* (1976) 424 U.S. 366 (cited U.S. Brief p. 9) is another commerce clause case wherein this Court explicitly declined to consider an equal protection claim. *Id.* at 368 n. 3. One of the basic grounds distinguishing the comparative retaliatory insurance tax statute from the cases cited in the first incomplete paragraph of page 10 of the United States' brief is the fact, discussed above, that the insurance retaliatory tax treats each out-of-state insurer individually and does not unreasonably classify all foreign insurers or insurers from each state together.

With regard to the application of the equal protection clause to the California principal office deduction, which until its 1976 repeal was a part of the California gross premiums privilege tax, the Board has already referred (Board's Motion, p. 13) to the applicable line of cases which authorizes the imposition of new privilege tax burdens on foreign corporations without imposing equivalent burdens on domestic corporations. However, detailed discussion of these cases is not necessary here, for (as shown on pages 11 through 13 of the Board's Motion) once the constitutional validity of the California retaliatory tax is established, the interrelated nature of that tax with the gross premiums tax provides an adequate state ground which relieves this Court of jurisdiction to determine the constitutional validity of the principal office deduction. Neither the United States' brief nor Western and Southern's brief in opposition to the Board's motion to dismiss or affirm challenges the Board's approach as to the applicability of the adequate state ground jurisdictional bar.

## CONCLUSION

Given the established current state of the law there is no substantial federal question presented by this case. If, as Western and Southern suggests, this Court should consider overruling its decision in *Prudential Insurance Co. v. Hobbs* and reconsidering the entire basis for its decision in *Prudential Insurance Co. v. Benjamin,* the case would become an important one of great interest to the forty-nine states which have comparative retaliatory insurance tax statutes.[4] However, it is respectfully submitted that the

4. The Board's motion (at p. 11 n. 9) states that "[f]orty-nine of the fifty states currently have insurance retaliatory taxes; *all* of those taxes are of the purely 'comparative' type . . . ." Appendix B to the Board's motion sets forth the statutes of the 49 states which support said statement. Said appendix notes that the New Mexico

reasoning forming the basis of the *Benjamin* decision is undeniably sound and that its application to the comparative retaliatory statute in *Hobbs* was equally consistent and appropriate. Western and Southern and, more particularly, the Solicitor General of the United States, should be aware that this Court has enough to do without reconsidering precedents, such as *Benjamin* and *Hobbs,* which were sound

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statutes pertain to insurance brokers and insurance agents respectively. Hawaii is the one state not represented on the list, consistent with our statement that one state does not currently have a retaliatory tax statute. On page 5 of its brief in opposition Western and Southern claims that the statements quoted above are "clearly erroneous" on the basis that "[n]o such taxes upon foreign insurance *companies* exist in New Mexico, North Carolina and Hawaii." (Emphasis added.) As noted above and in the Board's motion, Hawaii indeed has no such tax, and the insurance retaliatory taxes imposed by New Mexico are upon insurance brokers and agents respectively and not directly upon the insurance companies. These facts are not contrary to the Board's statements. Similarly, Florida Statutes section 624.429 imposes a purely comparative retaliatory tax in that it does not require discrimination by the insurer's home state to trigger its application; the fact that the Florida statute has an exception pertaining to foreign insurers with regional home offices in Florida (see Western and Southern's latest brief, p. 5) does not change this fact. As to North Carolina, the terms of the statute (N.C. Gen. Stat. § 105-288.8) quoted and relied upon by Western and Southern on page 5 of its latest brief only deal with increases of fees or taxes "imposed in this article". Section 105-228.8 is in chapter 105, article 8B of the North Carolina General Statutes; North Carolina's insurance retaliatory law (§ 58-152) is in chapter 58, article 17 of the North Carolina General Statutes. Additionally, section 58-152 has remained in effect since section 105-228.8 was enacted in 1945. Although it was reasonable under these circumstances to conclude that North Carolina law still would impose the retaliatory tax, it is understood from September 1980 conversations with North Carolina Department of Insurance authorities that said Department has exercised statutory discretion by not actually collecting the comparative retaliatory taxes provided for in section 58-152. At best Western and Southern's attack on the Board's statement has achieved partial adjustment only as to North Carolina; it would be most accurate to say that 49 of the 50 states have comparative retaliatory statutes in effect, and 48 of those 49 comparative retaliatory taxes are collected when applicable. Thus 96% of the states are collecting comparative retaliatory taxes whenever their statutory conditions are satisfied.

at their birth and which have not been weakened by any related line of cases or other subsequent developments.

For the reasons set forth above and in the Board's motion to dismiss or affirm, it is respectfully submitted that this Court should dismiss the appeal or, in the alternative, affirm the decision of the California Court of Appeal.

DATED: September 25, 1980

Respectfully submitted,

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# In the Supreme Court of the United States

OCTOBER TERM, 1980

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, APPELLANT

*v.*

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA

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*ON APPEAL FROM THE COURT OF APPEAL SECOND APPELLATE DISTRICT, STATE OF CALIFORNIA*

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## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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This brief is submitted in response to the Court's invitation of May 12, 1980.

### QUESTIONS PRESENTED

1. Whether Section 685 of the California Insurance Code violates the Equal Protection Clause of the Fourteenth Amendment by subjecting appellant, an Ohio

insurance company, to higher taxes than California insurance companies because Ohio, without distinction between foreign and domestic insurance companies, imposes greater taxes upon insurance companies than California imposes on domestic insurance companies.

2. Whether Section 12241 of the Cal. Rev. & Tax. Code violated appellant's Fourteenth Amendment right to equal protection of the laws by denying a substantial part of the credit against its premium taxes in the amount of the real estate taxes on its principal office in California that would otherwise be allowable to an in-state insurance company.

3. Whether the California tax statutes imposing heavier tax burdens on out-of-state insurance companies unconstitutionally discriminate against interstate commerce.

4. Whether the McCarran-Ferguson Act, 15 U.S.C. 1011–1015, authorizes California's statutory discrimination against interstate commerce.

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## OPINIONS BELOW

The order of the trial court and its Memorandum of Intended Decision and Conclusions of Law (J.S. App. 1a–24a) are not officially reported. The opinion of the Court of Appeal (J.S. App. 27a–34a) prior to its modification (J.S. App. 35a–36a) is reported at 99 Cal. App. 3d 410, 159 Cal. Rptr. 539. The order of the Supreme Court of California denying hearing (J.S. App. 36a) is unreported.

## JURISDICTION

The judgment of the Court of Appeal in favor of the validity of provisions of the Constitution and statutes of the State of California, the validity of which were drawn in question on the ground of repugnance to the Constitution of the United States, was entered on November 2, 1979 (J.S. App. 27a). The Court of Appeal denied a petition for rehearing on November 28, 1979 (J.S. App. 35a–36a). The Supreme Court of California denied a petition for hearing on December 27, 1979 (J.S. App. 36a). The notice of appeal to this Court was filed on February 11, 1980 (J.S. App. 37a–38a), and the Jurisdictional Statement was filed on March 13, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(2).

## CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Article I, Section 8, Clause 3 of the United States Constitution (the Commerce Clause) provides: "The Congress shall have Power * * * To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

Section 1 of the Fourteenth Amendment to the United States Constitution provides: "* * *No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State * * * deny to any person within its jurisdiction the equal protection of the laws."

The relevant provisions of the McCarran-Ferguson Act, 15 U.S.C. 1011–1013, are as follows:

> § 1011. *Declaration of Policy.*—Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.
>
> § 1012. *Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948.*—(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1980, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C. 41 *et seq.*], shall be applicable to the business of insurance to the ex-

tent that such business is not regulated by State Law.

§ 1013. *Suspension until June 30, 1948, of application of certain Federal laws; Sherman Act applicable to agreements to, or acts of, boycott, coercion, or intimidation.*—(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act [15 U.S.C. 41 *et seq.*], and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

The relevant provisions of the Constitution and Statutes of the State of California are set forth in J.S. App. 41a–46a.

## STATEMENT

1. Appellant brought this action in the Superior Court of the State of California for the County of Los Angeles to recover California taxes that it paid under protest for the period 1965–1971.

The facts were stipulated (J.S. App. 3a–4a) and may be summarized as follows: Appellant is an Ohio mutual life and disability insurance company which has its principal office in that State. Pursuant to Section 701 of the Cal. Ins. Code (West 1972),[1] appellant qualified

[1] Section 701 of the Cal. Ins. Code (West 1972) provides that a certificate of authority "shall be for an indefinite term and shall

to do business in California and was issued a Certificate of Authority for an indefinite term on July 1, 1956. Appellant has conducted a life and disability insurance business in California continuously since the issuance of its Certificate of Authority. Prior to 1965, appellant constructed an office building on land it owned in Los Angeles, and established its principal California office in that building. It has continued to maintain its principal California office in that building. However, appellant leases approximately 76% of the space in the building to tenants not related to its operations (J.S. App. 4a, 29a).

a. Pursuant to Sections 12201, 12202, and 12221 of the Cal. Rev. & Tax. Code (West 1970), California imposes upon every insurer doing business in the State, with exceptions not here relevant, an annual tax at a rate slightly in excess of 2.3% of gross premiums, less return premiums, received by the insurer upon business done in the State. Section 12204 of the Cal. Rev. & Tax. Code (West 1970) generally provides that this gross premium tax is, with stated exceptions, "in lieu of all other taxes, State, county, and municipal, upon such insurers and their property." Among the stated exceptions are taxes upon insurance companies' real estate and the so-called retaliatory tax authorized by Article XIII, Section 14–4/5(f)(3) of the California Constitution and imposed by Section 685 of the Cal. Ins. Code (West 1972) (J.S. App. 41a–43a). This latter provision addresses the case of an insurer doing business in California but incorporated in another state,

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expire with the expiration or termination of a corporate existence of the holder thereof."

where the state of incorporation would (even though without differentiation between domestic and out-of-state insurers) impose upon California insurers doing business in that state a greater amount of taxes than California would impose upon insurers of the other state doing business in California. In these circumstances, the California retaliatory tax requires that insurers of the other state (in addition to the tax otherwise imposed) pay an additional amount that would bring the total taxes and fees payable to California up to the amount that would have been payable to the other state.[2]

Acting under Section 685 of the Ins. Code, the State Board of Equalization issued a retaliatory tax assessment of $128,214.90 for 1965, and lesser amounts for the succeeding years through 1971, all of which appellant paid under protest.[3] It was stipulated that Ohio

[2]Prior to 1965, this retaliatory tax was imposed upon out-of-state insurers doing business in California only if their state discriminated against California insurers doing business in that other state, and in favor of domestic insurers. In 1964, however, the California Constitution was amended, and, since 1965, California has imposed the retaliatory tax upon out-of-state insurers doing business in California simply because the level of taxation upon insurers in their home state, undifferentiated between domestic and out-of-state insurers, is higher than the level of taxation upon insurers in California. See *Western & Southern Life Ins. Co.* v. *State Board of Equalization*, 4 Cal. App.3d 21, 84 Cal. Rptr. 88 (1970); *Atlantic Ins. Co.* v. *State Board of Equalization*, 255 Cal. App.2d 1, 62 Cal. Rptr. 784 (1967); *Franklin Life Ins. Co.* v. *State Board of Equalization*, 63 Cal.2d 222, 404 P.2d 477, 45 Cal. Rptr. 869 (1965).

[3]The retaliatory tax is computed as an amount in excess of the premiums tax. The amount of the premiums tax is also in contest for 1966–1971 (see *infra*, pages 6–7). Hence, the amounts of the two taxes for the years after 1965 are not separately designated. The aggregate amount in issue is $977,853.57, plus interest (J.S. App. 24a, 26a).

does not impose upon California insurers doing business in Ohio greater taxes, fees, etc. than upon domestic insurers doing business in Ohio, and the trial court so found (J.S. 6 n.2; J.S. App. 10a, 21a).[4]

b. Section 12241(a) of the Cal. Rev. & Tax. Code (West 1970) allows an insurer a credit against the annual premiums tax equal to the real estate taxes paid for the same year on real property owned by it on which was located its home office or principal office in the state.[5] In accordance, however, with an amendment to Article XIII, Section 14–4/5(e) of the California Constitution adopted in 1966, Section 12241(b) has provided thereafter that where a portion of the real property constituting the home or principal office was occupied by any person or persons other than the insurer, the credit allowed by Section 12241(a) is proportionately reduced. This reduction in the credit, however, is not applicable to insurers organized under the laws of California before December 31, 1966. As a result of these statutory provisions, appellant's credit against its premium taxes was reduced by approximately 76%, while similarly-situated California insurers suffered no reduction at all in their credit.

2. Appellant paid both the retaliatory tax assessments and the additional premiums taxes for 1966–1971 under protest, the latter because of the reduced "principal office" credit (J.S. App. 3a–4a). It thereafter filed claims for refund of the retaliatory taxes and

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[4]See also *Western & Southern Life Ins. Co.* v. *State Board of Equalization*, 4 Cal. App.3d 21, 84 Cal. Rptr. 88 (1970).

[5]This credit was repealed in 1976, effective January 1, 1977 (J.S. App. 16a).

the amount of the premiums taxes paid under protest, and, when those claims were denied, brought this action for refund of the taxes in issue in the Superior Court.

The Superior Court entered judgment in favor of appellant for the full amount of the refunds sought, plus statutory interest (J.S. App. 24a, 26a). It held that in discriminating against corporations engaged in interstate commerce and in favor of domestic corporations, both the retaliatory tax and the limits on the "principal office" credit violated the Commerce Clause and appellant's rights to due process and equal protection as guaranteed by the Fourteenth Amendment. The court also held that the California retaliatory tax was not authorized by the McCarran-Ferguson Act (J.S. App. 3a–24a).

The Court of Appeal reversed. It held that the retaliatory tax was authorized by the McCarran-Ferguson Act (J.S. App. 30a–31a). On the authority of its earlier decision in *Atlantic Ins. Co.* v. *State Board of Equalization*, 255 Cal. App. 2d 1, 62 Cal. Rptr. 784 (1967), the court held that the retaliatory tax did not violate either the commerce clause or appellant's right to equal protection of the laws under the Fourteenth Amendment (J.S. App. 32a–33a). The court stated with respect to *Atlantic Ins. Co.*, "Right or wrong, we feel impelled to follow it in the case before us" (J.S. App. 33a). Finally, the Court of Appeal ruled that it did not have to address the limits of the "principal office" credit allowed out-of-state insurers because to the extent that appellant's premiums tax was reduced, its retaliatory tax would be increased (J.S. App. 33a–

34a). The Court of Appeal denied a petition for rehearing (J.S. App. 35a–36a), and the Supreme Court of California denied appellant's petition for hearing (J.S. App. 36a).

## ARGUMENT

The California tax statutes at issue in this case violate the Equal Protection Clause of the Fourteenth Amendment, and are inconsistent with the limitations imposed upon the States by the Commerce Clause. Moreover, the McCarran-Ferguson Act, 15 U.S.C. 1011–1015, does not relax the limitations that the Fourteenth Amendment imposes upon the States. *State Bd. of Ins.* v. *Todd Shipyards*, 370 U.S. 451 (1962). Nor should it be construed to authorize state action hostile to, and discriminatory against, out-of-state insurers engaged in interstate commerce in the manner of the California statutes.

1. Appellant qualified to do business in California in 1956. Since that time, it has held an indefinite license, coterminous under California law with its corporate existence, to do business as a life and disability insurer. Accordingly, the taxes here in question are not analogous to an entrance fee imposed by California upon a foreign corporation, as a condition of doing business within the state, of the type that the Court has upheld. See *WHYY* v. *Glassboro*, 393 U.S. 117, 119 (1968). On the contrary, the so-called retaliatory tax imposed by Section 685 of the Insurance Code, and the limitation on the "principal office" credit against the premiums tax imposed by Section 12241(b) of the

Revenue and Taxation Code, are burdens imposed upon appellant because it is a foreign corporation. Indeed, appellant is subject to the retaliatory tax solely because Ohio, its state of incorporation, imposes upon insurers, though in completely evenhanded fashion, a somewhat higher level of taxation than California.

We submit that California has no legitimate interest in Ohio's level of taxation or fiscal structure when no discriminatory action against California citizens or corporations is involved. Cf. *Toomer* v. *Witsell*, 334 U.S. 385, 395–407 (1948). The several states have different resources, populations, social and economic conditions, levels of public services, fiscal structures, methods and sources of raising revenue, and tax burdens, both in gross and per capita. With respect to other states, where no discriminatory or hostile action is involved, the states are largely autonomous in these matters. And even if another state has engaged in discriminatory action, as this Court has pointed out, the Constitution does not contemplate the economic warfare of reprisal and retaliation. *A&P Tea Co.* v. *Cottrell*, 424 U.S. 366 (1976).

Since Ohio does not in fact discriminate against California or other insurers, there is no greater justification for the tax imposed by Section 685 of the Ins. Code than if California imposed upon Ohio residents who happened to own land in California a higher property tax than was otherwise imposed simply because the level of real property taxation in Ohio was higher than in California. Section 685 and the limitation upon the "principal office" credit mandated by Section

12241(b) of the Rev. & Tax. Code[6] constitute tax burdens imposed upon foreign insurance corporations because they are foreign corporations. The decisions of this Court have uniformly struck down such discriminatory taxation as violative of the Equal Protection Clause of the Fourteenth Amendment. *E.g.*, *WHYY* v. *Glassboro*, 393 U.S. 117 (1968); *Reserve Life Ins. Co.* v. *Bowers*, 380 U.S. 258 (1965); *Wheeling Steel Corp.* v. *Glander*, 337 U.S. 562 (1949); *Hanover Fire Ins. Co.* v. *Harding*, 272 U.S. 494 (1926); *Southern Ry.* v. *Greene*, 216 U.S. 400 (1910).

2. Throughout the history of this Court's decisions involving state taxation of interstate commerce, there have been "some firm peaks of decision which remain unquestioned." *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 457 (1959). "Among these is the fundamental principle that * * *: No State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business.'" *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 329 (1977). There, the Court held that New York could not impose a tax "to favor local commercial interests over out-of-state businesses," even though the discrimination was "between two types of interstate transactions" (429 U.S. at 335).

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[6] If, as we believe, Section 685 of the Insurance Code is unconstitutional, it is no longer possible to avoid, as did the Court of Appeal, passing upon the constitutionality of the discriminatory aspects of the "principal office" credit limitation imposed by Section 12241(b) of the Rev. & Tax. Code (see J.S. App. 33a–34a).

Only last Term, the Court applied the same criteria in striking down, under the Commerce Clause, a Florida statute that prohibited an out-of-state bank holding company from owning or controlling a business furnishing investment advisory services to the general public. *Lewis* v. *BT Investment Managers, Inc.*, No. 79–45 (June 9, 1980). As the Court there observed, "where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected," quoting from *Philadelphia* v. *New Jersey*, 437 U.S. 617, 624 (1978).

Judged by these standards, the California statutes here in question would appear, if standing alone, to be inconsistent with the Commerce Clause, and the court below did not assert otherwise. The remaining question is whether the McCarran-Ferguson Act should be construed to permit the "simple economic protectionism" exemplified by the California statutes involved in the case.

We think not and submit that the history and purpose of the McCarran-Ferguson Act demonstrate that it should not. But we start with a more fundamental premise. As the Court pointed out in *Boston Stock Exchange*, quoting from earlier decisions, "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States" (429 U.S. at 328). An Act of Congress should therefore not be construed to frustrate that purpose unless by its explicit terms the legislation authorizes the practice of economic protectionism by the States. Indeed, on several occasions, this Court has declined to construe federal statutes to permit state action that would have

excluded or discriminated against out-of-state competition, even where the federal statute authorized State regulation. *Lewis* v. *BT Investment Managers, Inc.*, No. 79–45 (June 9, 1980), slip op. 16–21; *Hood & Sons* v. *DuMond*, 336 U.S. 525, 540–545 (1949); *Scott* v. *Donald*, 165 U.S. 58, 100 (1897). And where the Court upheld earlier federal legislation with respect to interstate shipments that reinforced or authorized state restrictions on the sale of interstate goods, the Court was careful to point out that the restrictions were nondiscriminatory. *Ky. Whip & Collar Co.* v. *I.C.R. Co.*, 299 U.S. 334, 351 (1937); *Whitfield* v. *Ohio*, 297 U.S. 431, 439–440 (1936).

The McCarran-Ferguson Act was passed in response to this Court's decision in *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).[7] In that case, the Court held that multi-state insurers were engaged in commerce among the several States, and were subject to the provisions of the Sherman Antitrust Act, 15 U.S.C. 1 and 2. Many people professed to believe that the decision effectively immunized multi-state insurers, and a large part of the business of insurance, from state regulation and from state taxa-

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[7] This Court has examined the legislative history of the McCarran-Ferguson Act in a substantial number of cases. See, *e.g.*, *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979); *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531 (1978); *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969); *State Bd. of Ins.* v. *Todd Shipyards*, 370 U.S. 451 (1962); *FTC* v. *Travelers Health Ass'n*, 362 U.S. 293 (1960); *SEC* v. *Variable Annuity Life Insurance Co.*, 359 U.S. 65 (1959); *FTC* v. *National Casualty Co.*, 357 U.S. 560 (1958); *Maryland Casualty Co.* v. *Cushing*, 347 U.S. 409 (1954); *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408 (1946).

tion. That such a belief was greatly overdrawn was demonstrated not only by the Court's subsequent decision in *Robertson* v. *California*, 328 U.S. 440 (1946), but also by the contemporaneous treatment of interstate carriers and of manufacturers, wholesalers, and others engaged in interstate commerce on a large scale. Congress, nevertheless, felt impelled to act. The reason for action and the intended scope of action are well described in the Report of the House Committee on the Judiciary, H.R. Rep. No. 143, 79th Cong., 1st Sess. 2–3 (1945), as follows:

> Inevitable uncertainties which followed the handing down of the decision in the *Southeastern Underwriters Association case*, with respect to the constitutionality of State laws, have raised questions in the minds of insurance executives, State insurance officials, and others as to the validity of State tax laws as well as State regulatory provisions; thus making desirable legislation by the Congress to stabilize the general situation.
>
> * * * Your committee believes there is urgent need for an immediate expression of policy by the Congress with respect to the continued regulation of the business of insurance by the respective States. Already many insurance companies have refused, while others have threatened refusal to comply with State tax laws, as well as with other State regulations, on the ground that to do so, when such laws may subsequently be held unconstitutional in keeping with the precedent-smashing decision in the *Southeastern Underwriters case*, will subject insurance executives to both civil and criminal actions for misappropriation of company funds.
>
> * * * * *

> It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern Underwriters Association case.*

The pertinent Senate report, S. Rep. No. 20, 79th Cong., 1st Sess. (1945), is largely to the same effect. In presenting the Conference Report to the Senate, Senator McCarran read from the Report of the House Judiciary Committee, and added, "In other words, we give to the States no more powers than those they previously had, and we take none from them." 91 Cong. Rec. 1442 (1945).

The congressional debate principally concerned antitrust legislation—whether it should be suspended, partially suspended, restored after a period of suspension, etc. See 91 Cong. Rec. 478–488, 1085–1094, 1396, 1442–1444, 1477–1489 (1945).[8] The uncertainties of state taxation of insurance companies are mentioned from time to time, but rarely more than briefly.[9] Typical was Representative Springer's remark that the pending measure would allow the states "to collect the taxes now permitted—all without Government interference." 91 Cong. Rec. 1092 (1945). See also, *e.g.*, 91

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[8] Sections 2 and 3 of the Act, 15 U.S.C. 1012 and 1013, embody the compromises that were reached after extended discussions.

[9] For example, Representative Walter reported to the House that the Attorney General of North Carolina had ruled that the State could no longer collect taxes paid by insurance companies. See 91 Cong. Rec. 1085 (1945).

Cong. Rec. 482 (1945) (Senator Radcliffe, "The right of the States * * * to collect taxes should not be terminated"). There is nothing explicit in the debate, the committee reports, or the statute that suggests that the states were given authority to erect barriers of economic protectionism. Insofar as state taxes were concerned, Congress was aware that current state revenues were in jeopardy of interruption, and intended to remove that hazard and uncertainty. Nothing suggests that Congress ever considered, or that the states were in fact given, enhanced authority to exclude, or to interfere with, competition by out-of-state insurers. And this Court's decisions under the McCarran-Ferguson Act have not in other respects construed the Act to sanction anticompetitive arrangements.[10] There is no reason why the tax provisions should be construed to permit anticompetitive taxation that discriminates against out-of-state insurers.

*Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408 (1946), principally relied upon by the court below (J.S. App. 12a–14a), is not to the contrary. The principal thrust of that decision was to establish the power of Congress, challenged by the appellant in that case, to authorize the states to take action that, in the absence of congressional action, might be deemed to be inconsistent with the Commerce Clause. What Congress had in fact authorized received lesser consideration. In that the Court was explicit: "It is not neces-

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[10] See, *e.g.*, *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979); *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531 (1978).

sary to spend much time with interpreting the McCarran Act" (328 U.S. at 429). The Court refrained from addressing the question whether the South Carolina tax in issue was in fact discriminatory (*id.* at 428), and did not rule upon the validity of any state statute not substantially identical with that of South Carolina (*id.* at 437 n.40). There is no reason to believe that *Prudential Insurance Co.* v. *Hobbs*, 328 U.S. 822 (1946) and *Prudential Insurance Co.* v. *Indiana*, 328 U.S. 823 (1946), both decided per curiam a week later on the authority of *Benjamin*, decided more than the principal decision. In sum, unlike *Prudential*, the question in this case does not involve the scope of Congress's power. It simply involves the proper construction of legislation that Congress enacted. We believe that it should not be construed to uphold California's statutory protectionism.

## CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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NO. 79-1423

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

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On Appeal from the Court of Appeal, Second Appellate District, State of California

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## BRIEF FOR THE APPELLANT

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November 14, 1980

## QUESTIONS PRESENTED

The questions presented by this appeal are:

1. Do the California constitutional and statutory provisions levying an additional retaliatory tax on some foreign insurance companies but not on domestic insurance companies and placing different burdens on foreign insurance companies depending on the laws of their respective states of incorporation deny to those foreign insurance companies required to pay such additional tax the due process of law and equal protection guaranteed by Section 1 of the Fourteenth Amendment to the United States Constitution?

2. Do the California constitutional and statutory provisions granting domestic insurance companies a credit against premium taxes for the full amount of California real property taxes paid on their principal offices in the state while denying part of such credit to some but not all foreign insurance companies deny to foreign insurance companies receiving less than the full credit the due process of law and equal protection guaranteed by Section 1 of the Fourteenth Amendment to the United States Constitution?

3. Do the California constitutional and statutory tax provisions leving an additional retaliatory tax on some foreign insurance companies but not on domestic insurance companies and placing different burdens on foreign insurance companies depending on the laws of their respective states of incorporation impose a discriminatory burden on interstate commerce prohibited by Article I, Section 8, of the United States Constitution?

4. Do the California constitutional and statutory provisions granting domestic insurance companies a credit against premium taxes for the full amount of California real property taxes paid on their principal offices in the state while denying part of such credit to some but not all foreign insurance companies impose a discriminatory burden on interstate commerce prohibited by Article I, Section 8, of the United States Constitution?

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STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

**On Appeal from the Court of Appeal, Second Appellate District, State of California**

## BRIEF FOR THE APPELLANT

### OPINIONS BELOW

The unreported Intended Decision, Memorandum of Intended Decision, Conclusions of Law and Judgment of the Superior Court of the State of California for the County of Los Angeles are printed in the Joint Appendix, beginning at page 55. The opinion of the Court of Appeal of the State of California, Second Appellate District, and the order of such Court of Appeal modifying its opinion and denying the Petition for Rehearing are printed in the Joint Appendix, beginning at page 80. The original Court of Appeal opinion before its modification in response to the Petition for Rehearing

is reported at 99 Cal. App. 3d 410, 159 Cal. Rptr. 539 (1979). The decision of the Supreme Court of California denying a hearing ("Hearing Denied.") remains unpublished, but is printed on page 89 of the Joint Appendix.

## GROUNDS FOR JURISDICTION

Appellant, The Western and Southern Life Insurance Company ("Western and Southern"), appeals from the judgment of the Court of Appeal of the State of California, Second Appellate District, entered November 2, 1979, reversing the decision of the Superior Court of the State of California for the County of Los Angeles, entered October 27, 1977. A Petition for Rehearing by the Court of Appeal was filed by Western and Southern on November 19, 1979. In an order filed November 28, 1979, the Court of Appeal modified its opinion and denied rehearing. On December 11, 1979, Western and Southern filed a petition for hearing by the Supreme Court of California, which denied the petition on December 27, 1979. Notice of Appeal to this Court was filed with the Court of Appeal of the State of California, Second Appellate District, on February 11, 1980. Western and Southern's Jurisdictional Statement was filed in this Court on March 13, 1980, and probable jurisdiction was noted October 6, 1980.

Western and Southern, an insurance company incorporated in Ohio, asserts that the following actions of Appellee, The State Board of Equalization of the State of California (the "Board"), violate the Constitution of the United States.

1. The levying of retaliatory taxes upon Western and Southern for the years 1965 through 1971, under California Constitution, Article XIII, section 14-4/5(f)(3), as amended November 3, 1964 (California Constitution, West. Supp. 1964); California Insurance Code, section 685 (West 1972); and California Revenue and Taxation Code, section 12284 (West 1970).

2. The denial of a credit for the full amount of real property taxes paid on Western and Southern's principal office in California against its California premium taxes for 1966 through 1971, under California Constitution, Article XIII, section 14-4/5(e) (West Supp. 1966); and California Revenue and Taxation Code, section 12241 (West 1970).

Western and Southern paid the additional taxes under protest each year and filed claims for refund thereof. The Board denied the claims, and Western and Southern brought suit for refund in the Superior Court of Los Angeles County under authority of California Revenue and Taxation Code, section 13103.[1]

Western and Southern alleged in its complaint, and the trial court found, that the California Constitution and correlative taxing statutes levied an unconstitutional burden upon interstate commerce and discriminated against Western and Southern contrary to Section 8 of Article I and Section 1 of the Fourteenth Amendment of the United States Constitution. The Court of Appeal reversed the trial court, expressly holding that the California laws did not violate the cited provisions of the United States Constitution. The Supreme Court of California denied Western and Southern's Petition for Hearing, and the Court of Appeal decision became final on December 27, 1979. The jurisdiction of this Court therefore rests upon 28 U.S.C. § 1257(2).

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[1] Statutory Appendix hereto, page 7a.

## CONSTITUTIONAL AND STATUTORY PROVISIONS

The provisions of the United States Constitution, of the United States laws, of the California constitution and of the California laws involved in this case are the following:

U.S. Constitution, Article I, Section 8, Clause 3

U.S. Constitution, Amendment XIV, Section 1

McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. §§ 1011-1015

California Constitution, Article XIII, Section 14-4/5(e)

California Constitution, Article XIII, Section 14-4/5(f)(3)

California Insurance Code, Section 685

California Revenue and Taxation Code:

Section 12241

Section 12284

Section 13102

Section 13103

These constitutional and statutory provisions are lengthy and are printed in the Statutory Appendix hereto, beginning at page 1a.

## STATEMENT OF THE CASE

Western and Southern is an Ohio corporation engaged in the life insurance business. It has a Certificate of Authority to do business in California issued pursuant to California Insurance Code section 701. This certificate was issued for an indefinite term and became effective July 1, 1956. (Joint Appendix ("JA"), p. 43) Since that date Western and Southern has continually done business in California. Prior to 1965, it constructed an office building on land owned in Los Angeles, California, established its principal California office therein, and occupied it during all the years here pertinent. (Stipulation of Facts ¶ 3, JA p. 5)

From 1965 to 1971, the Board assessed against Western and Southern "retaliatory taxes" under the authority of the California Constitution, Insurance Code, and Revenue and Taxation Code. These provisions impose an additional tax on a foreign insurance company doing business in California when the state of incorporation of the foreign insurer imposes on California insurance companies doing business in the foreign state higher taxes than California imposes on insurance companies from that foreign state doing business in California. By definition, this California tax is *never* imposed on an insurance company incorporated in California, and it is imposed only on some foreign insurance companies, namely, those incorporated in states which impose greater taxes on insurers than California. Imposition of retaliatory taxes by California is not dependent upon unequal treatment of foreign and domestic insurers by the foreign state. Were it so dependent, the tax would be called an "anti-discrimination retaliatory tax" (JA p. 61) because its objective would be to discourage other states from discriminating against California insurance companies by taxing them at rates higher than they tax their own domestic insurers.

The parties have stipulated that, in the years here pertinent, Ohio did not impose a higher tax burden on California (or other foreign) insurers than it imposed on its own domestic insurers,[2] and the trial court so found.[3] But the tax burden on insurance companies, both domestic and foreign, is higher in Ohio than it is in California. Therefore, an Ohio insurance company doing business in California pays an additional pen-

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[2] ¶ 2 of the Stipulation of Facts filed in the trial court states:

> . . . by the laws of the State of Ohio, taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations or prohibitions imposed upon life insurers of California analogous to plaintiff doing business in Ohio, or upon their agents therein, were not in excess of those imposed by the State of Ohio upon such insurers of Ohio or upon their agents therein. JA p. 5.

[3] ¶ 7, Conclusions of Law, JA p. 75.

alty tax to the State of California. Because this tax is based on a comparison of the tax burdens upon foreign insurers in the state of incorporation of the foreign insurer with California's tax burdens on foreign insurers, without reference to the retaliatory laws of either state, it is known as a "comparative retaliatory tax." Western and Southern brings before this Court the question of the constitutionality of California's comparative retaliatory tax.

To exacerbate Western and Southern's tax predicament, the Board also denied it full credit against its premium taxes for real property taxes paid with respect to its principal office in California for 1966 and later years under purported authority of the California Constitution and Revenue and Taxation Code. These provisions grant California insurance companies a credit against insurance premium taxes (the "principal office deduction") for the full amount of real property taxes levied on their principal offices in California without regard to the percentage of such offices occupied by the insurance companies. A similar credit is extended to foreign insurance companies which occupy 75% or more of the property comprising their principal offices in California. However, the principal office deduction for foreign insurance companies, such as Western and Southern, occupying less than 75% of their property, is limited to the percentage of such real property taxes equal to the percentage of principal office property occupied by them. Western and Southern challenges as unconstitutional the granting of a credit against premium taxes to a domestic insurer and to some foreign insurers greater than the credit granted to other foreign insurers, such as Western and Southern.

The trial court also pointed out (¶ 17, Conclusions of Law, JA p. 77) that because the retaliatory tax is computed as the difference between the total of the taxes (including premium taxes and real property taxes) already paid by the foreign insurer in California and the total tax burden on a hypothetical similar California company doing business in the foreign insurer's state of incorporation, even if the foreign

insurer were granted the full principal office deduction, the retaliatory tax would be increased by the amount of the principal office deduction credited against the premium tax, again effectively denying to the foreign insurance company the principal office deduction.

As a result of these two aspects of California's taxation of foreign insurance companies, Western and Southern was forced to pay to California $977,853.57 more in taxes for the years here in isssue than a California insurer of the same size and asset mix and doing equivalent business would have paid. After its timely claims for refund of these additional taxes were denied by the Board, Western and Southern commenced this action on May 17, 1971, by filing a complaint in the Superior Court of the State of California for the County of Los Angeles, seeking refund of the retaliatory taxes paid under protest for the years 1965 through 1969, inclusive, and premium taxes paid under protest for the years 1966 through 1969, inclusive.

By stipulation of the parties filed December 31, 1976, Western and Southern's complaint was amended to include a prayer for refund of additional retaliatory and premium taxes paid for the years 1970 and 1971, subsequent to the filing of the original complaint, and the Board's answer was extended to cover such amended complaint. (JA pp. 44-46) Also on December 31, 1976, the parties filed a Stipulation of Facts (JA pp. 3-42) which was admitted into evidence by minute order of the trial court on June 10, 1977. (R. p. 665)

The Superior Court of the State of California for the County of Los Angeles tried the case without a jury on the evidence presented in the Stipulation of Facts and, following oral argument of counsel addressed principally to the federal constitutional questions, found that both the retaliatory tax and the denial of the full credit for real property tax on its principal office violated Western and Southern's rights under the United States Constitution. (JA p. 71)

The Board appealed the Superior Court's decision to the

Court of Appeal of the State of California, Second Appellate District, on December 21, 1977, which, in its November 2, 1979, decision, reversed the lower court. (JA p. 80) This appeal followed.

## SUMMARY OF ARGUMENT

I. The Fourteenth Amendment guarantees equal protection of the laws to all persons, and a corporation is a person likewise entitled to protection from arbitrary legislative action. *Connecticut General Life Insurance Co.* v. *Johnson,* 303 U.S. 77 (1938); *Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 (1926).

Once a corporation is admitted to do business within a state for an indefinite term, the state must accord the corporation equal protection under its laws during the period for which the corporation has been admitted to do business. As this Court held in *Southern Railway Co.* v. *Greene,* 216 U.S. 400 (1910), an additional tax levied by Alabama on all foreign corporations but not on domestic corporations long after the Southern Railway Company had been admitted to do business in the state for an unlimited term violated equal protection rights of the foreign corporations.

The *Southern Railway* decision was expanded in *Hanover Fire Insurance Co.* v. *Harding, supra,* where this Court held that Illinois could not force a foreign insurance corporation licensed on a year-to-year basis to waive rights secured to it by the Constitution in order to gain readmission to do business in Illinois the following year. This Court, voiding a tax on the net receipts of foreign insurers, stated that a foreign corporation, after admission to do business in a state, "stands equal with and is to be classified with domestic corporations of the same kind." 272 U.S. at 510-11. Likewise, in *Power Manufacturing Co.* v. *Saunders,* 274 U.S. 490 (1927), this Court held unconstitutional an Arkansas statute authorizing suit against a foreign corporation in any county of the state,

while requiring suits against domestic corporations to be brought in a county where the corporation had a place of business or its chief officer resided.

"Equal protection" does not preclude California from drawing reasonable distinctions between persons, but requires that persons similarly situated receive like treatment. *In re Estate of Ginochio,* 43 Cal. App. 3d 412, 117 Cal. Rptr. 565 (1st Dist. 1974). It is fundamental that the classification of corporations into domestic and foreign categories is unreasonable and violates the equal protection clause. *Western Union Telegraph Co.* v. *Frear,* 216 F. 199 (W.D. Wis. 1914).

In *Wheeling Steel Corp.* v. *Glander,* 377 U.S. 562 (1949), this Court examined an Ohio statute which provided that intangible property arising out of business transacted in Ohio by a non-resident was subject to taxation, whereas intangible property of a resident arising out of business transacted out of state was not subject to tax. This Court found that the statute violated the equal protection clause because the difference in the tax treatment was based, not on Ohio's relationship to the transactions in question, but on the differing residences of the persons engaging in the transactions.

Discriminatory taxation of a foreign life insurance corporation was struck down in *Reserve Life Insurance Co.* v. *Bowers,* 380 U.S. 258 (1965), upon the authority of the *Wheeling Steel* case. This Court invalidated an Ohio statute which levied a personal property tax on foreign, but not domestic insurance companies. More recently, a New Jersey statute was held unconstitutional based upon its classification of non-profit corporations into foreign and domestic categories for purposes of qualifying for real and personal property tax exemptions. *WHYY* v. *Glassboro,* 393 U.S. 117 (1968).

Application of the cited cases to the California system of taxing Western and Southern, an Ohio corporation, demonstrates that the system violates the equal protection guarantees of the Fourteenth Amendment. The difference in the amount

of the principal office deduction allowed to California insurers as contrasted to foreign insurers, such as Western and Southern, occupying less than 75% of their property, is based upon one fact: the state of incorporation of the insurer. It is patent that Western and Southern was subject to the same real estate taxes on its California property as a California corporation; it paid the taxes to the same governmental authority; its existence in California does not burden the state more heavily than a domestic corporation.

The same logic applies to the assessment by California of its comparative retaliatory tax, and the Board cannot justify this tax based upon discriminatory treatment of foreign insurance companies by Ohio. It is stipulated that Ohio did not impose a higher tax burden on California insurers than on its own domestic insurers.

In *Wheeling Steel,* Ohio sought to justify its resident, non-resident classification scheme by suggesting that other states whose citizens were victims of the discrimination could remedy the unfairness by adopting similarly discriminatory systems. This Court pointed out that the "offer of reciprocity" could not restore to the non-residents the equality denied by the Ohio tax on intangibles. Similarly, it is implausible to argue that Ohio is responsible for remedying the tax predicament created by California. Ohio has adopted a system of taxation which it deems to be desirable. California's system must stand or fall on its effect on insurers within its own borders. That effect is discriminatory and therefore unconstitutional. *Reserve Life Insurance Co.* v. *Bowers, supra.*

II. The trial court adopted this view and held that California's scheme of taxing foreign insurers was invalid; the Court of Appeal reversed because it believed that this Court in *Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 833 (1946), and *Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408 (1946), had determined that the discrimination against foreign insurers was sanctioned by the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015.

That law was passed by Congress in 1945 to preserve state regulation and taxation of insurers from attacks based upon the commerce clause following the decision by this Court in *United States* v. *South-Eastern Underwriters Association,* 322 U.S. 533 (1944), that an insurance company conducting a substantial part of its business across state lines was engaged in interstate commerce. The *South-Eastern Underwriters* decision overturned the 76-year-old precedent of *Paul* v. *Virginia,* 75 U.S. (8 Wall.) 168 (1868) and resulted in the initiation of a series of cases ultimately decided in 1946, which claimed that the commerce clause precluded the states involved from regulating a foreign insurer or from taxing it differently than a domestic company.

Only one of the series of cases, *Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 822 (1946), involved a retaliatory tax, that in effect in Kansas. The sole contention made with respect to such tax was that the commerce clause was violated. The Kansas Supreme Court had held, *In re Insurance Tax Cases,* 160 Kan. 300, 161 P.2d 726 (1945), that *South-Eastern Underwriters* did not render its tax void, and that Congress did not exceed its powers in passing the McCarran-Ferguson Act. This Court affirmed *per curiam,* citing as authority *Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408 (1946). The *Benjamin* decision, rendered a week before *Hobbs,* dealt with the validity of a premiums tax levied on foreign insurers in the State of South Carolina. In upholding the South Carolina tax, the Court said:

> We express no opinion concerning the validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein. 328 U.S. at 431, n. 4.

This Court also said that it did not intend to imply that the McCarran-Ferguson Act exempted all state statutes regulating interstate insurance business from attack under the commerce clause or other constitutional criteria. *Id.* at 430.

Thus, because the Supreme Court in *Hobbs* merely affirmed in summary fashion the Kansas Supreme Court's limited holding, *Hobbs* should not be read as requiring approval of California's retaliatory tax on foreign insurers. There was no evidence of discrimination between foreign and domestic insurers in the three Kansas tax statutes in question. *In re Insurance Tax Cases,* 160 Kan. at 311, 161 P.2d at 734. The *Benjamin* decision should not be taken as a stamp of approval upon California's discriminatory retaliatory taxation of interstate commerce, first, because this Court said it was expressing no opinion regarding taxing statutes not substantially identical to the South Carolina statute under consideration, and second, because of the disclaimer that the Court did not intend wholesale approval of *all* state insurance regulations and taxes.

Western and Southern believes the California Court of Appeal incorrectly interpreted both *Hobbs* and *Benjamin.* If it did not, Western and Southern urges this Court to reexamine its earlier decisions. The legislative history of the McCarran-Ferguson Act indicates that Congress merely intended to relieve the uncertainty created by the *South-Eastern Underwriters* decision and gave the states no more powers than those they previously had. In *State Board of Insurance* v. *Todd Shipyards Corp.,* 370 U.S. 451 (1962), state taxation and regulation of insurers were held subject to the constitutional restraints imposed, *inter alia,* by the due process clause. While the commerce clause does not prohibit some state taxation of interstate insurance transactions, particularly in view of the Congressional purpose of the McCarran-Ferguson Act, both California's retaliatory tax and its refusal to grant all foreign insurers the full principal office deduction constitute such substantial and unreasonable burdens on interstate commerce that they should no longer escape the commerce clause strictures.

The basic purpose of the commerce clause is to create an area of free trade among the several states. *Boston Stock Exchange* v. *State Tax Commission,* 429 U.S. 318 (1977). In

the *Boston Stock Exchange* case, this Court held that a New York statute imposing a greater transfer tax on out-of-state securities sales than on in-state security sales violated the commerce clause. The Court stated that obstructions to competition between the states cannot be upheld, even when they are sought to be justified as measures to assure the economic health of local industry.

California's retaliatory tax discriminates against interstate commerce in preference to local industry. The tax applies only to foreign insurers incorporated in the seventeen states which place higher tax burdens upon insurers than California. (See fn. 4, infra, p. 32.) Even if the home state of the foreign insurer taxes both domestic and foreign insurers generally on an equal footing, without regard to retaliation, California imposes its punitive retaliatory tax. The tax directly obstructs interstate commerce and substantially disrupts the equilibrium of free trade among the states; it violates the commerce clause.

## ARGUMENT

### I. CALIFORNIA'S SYSTEM OF TAXING FOREIGN INSURANCE COMPANIES VIOLATES THE GUARANTEES OF SECTION 1 OF THE FOURTEENTH AMENDMENT.

The constitutional guarantees of "due process of law" and "equal protection of the laws" protect all persons from arbitrary legislative action, and a corporation is a person entitled to such guarantees. *Connecticut General Life Insurance Co.* v. *Johnson,* 303 U.S. 77 (1938); *Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 (1926).

Once a corporation is admitted to do business within a state, the state must guarantee the corporation equal protection under its laws during the period for which it has been admitted to do business. *Southern Railway Co.* v. *Greene,* 216 U.S. 400 (1910). In *Southern Railway,* the plaintiff was a foreign corporation admitted to do business in Alabama when both foreign and domestic corporations paid the same Alabama franchise taxes and fees for the privilege of engaging in business in that state. After the plaintiff had conducted business in Alabama for several years, a new and additional franchise tax was levied upon all foreign corporations within the state but not upon domestic corporations. This Court held that the imposition of such a tax violated the equal protection clause of the Fourteenth Amendment. In so holding the Court distinguished prior cases which held that a state could impose discriminatory burdens upon foreign corporations as conditions of admission to do business within the state, and noted:

> It is sufficient for the present purpose to say that we are not dealing with a corporation seeking admission to the State of Alabama, nor with one which has a limited license, which it seeks to renew, to do business in that State; nor with one which has come into the State upon

> conditions which it has since violated. In the case at bar we have a corporation which has come into and is doing business within the State of Alabama, with the permission of the State and under the sanction of its laws, and has established therein a business of a permanent character, requiring for its prosecution a large amount of fixed and permanent property, which the foreign corporation has acquired under the permission and sanction of the laws of the State. *Id.* at 413-14.

The *Southern Railway* opinion quoted from *Philadelphia Fire Association* v. *New York*, 119 U.S. 110 (1886), an apparently contradictory case, to show that the latter's holding expressly was predicated upon the facts that the state had licensed the corporation only from year to year and had retained authority to exclude it at the end of any year. 216 U.S. at 415. By contrast, it was noted that the Southern Railway Company had been admitted for an unlimited term. Therefore, Alabama's new additional tax, which was a tax more onerous to foreign corporations than to domestic corporations, violated the Fourteenth Amendment. 216 U.S. at 413-18.

A line of demarcation again was sharply drawn in *Hanover Fire Insurance Co.* v. *Harding*, 272 U.S. 494 (1926), where this Court expanded the *Southern Railway* decision. In *Hanover*, the State of Illinois attempted to enforce a tax on the net receipts of foreign insurers. This tax was not one of the conditions upon which the insurance company originally was authorized to do business in Illinois, and it did not apply to domestic insurance companies. Although Illinois required foreign insurers to renew their licenses annually, the Court held that the state could not force foreign corporations to waive a right secured to them by the Constitution of the United States by characterizing a tax as the price of readmission for the following year. The Court distinguished the imposition of such a condition to the renewal of a license from the imposition of discriminatory conditions upon foreign corporations initially seeking admission to do business in a state:

> In subjecting a law of the state which imposes a charge upon foreign corporations to the test whether such a charge violates the equal protection clause of the 14th Amendment, a line has to be drawn between the burden imposed by the state for the license or privilege to do business in the state and the tax burden which, having secured the right to do business, the foreign corporation must share with all the corporations and other taxpayers of the state. With respect to the admission fee, so to speak, which the foreign corporation must pay to become a quasi citizen of the state and entitled to equal privileges with the citizens of the state, the measure of the burden is in the discretion of the state and any inequality as between the foreign corporation and the domestic corporation in that regard does not come within the inhibition of the 14th Amendment; *but after its admission, the foreign corporation stands equal and is to be classified with domestic corporations of the same kind.* *Id.* at 510-11. (Emphasis supplied.)

Once a foreign corporation has been admitted to do business in a state, that state "may not exact as a condition to the corporation's engaging in business within its limits that its rights secured to it by the Constitution of the United States may be infringed." *Id.* at 507. To the same effect was *Power Manufacturing Co.* v. *Saunders,* 274 U.S. 490 (1927), involving a venue statute of Arkansas authorizing foreign corporations doing business in the state to be sued in any county in the state while requiring actions against domestic corporations to be brought in a county where it had a place of business or in which its chief officer resided. This Court said:

> The contention . . . that the defendant impliedly assented to the venue provisions is answered and refuted by repeated decisions holding that a foreign corporation by seeking and obtaining permission to do business in a state does not thereby become obligated to comply with or estopped from objecting to any provision in the state statutes which is in conflict with the Constitution of the United States. *Id.* at 495.

While Western and Southern's certificate of authority to do business in California specifically included the language that it was conditioned upon compliance with the laws and lawful requirements then in effect and as thereafter changed or amended, the certificate was for an indefinite term (¶ 1, Stipulation of Facts, JA p. 4), and did not require application and renewal year by year, as was the case in *Lincoln National Life Insurance Co.* v. *Read*, 325 U.S. 674 (1945).

Equal protection as preserved by the federal Constitution does not preclude California from drawing reasonable distinctions between persons, but requires that persons similarly situated receive like treatment. *In re Estate of Ginochio*, 43 Cal. App. 3d 412, 117 Cal. Rptr. 565 (1st Dist. 1974). In determining whether persons are similarly situated, legislative classification violates the equal protection standards unless the classification is based upon some difference in the classes having a substantial relation to the purpose for which the legislation is designed. *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522 (1959); *Hartford Steam Boiler Inspection & Insurance Co.* v. *Harrison*, 301 U.S. 459 (1937); *Concordia Fire Insurance Co.* v. *Illinois*, 292 U.S. 535 (1933); *Russian Hill Improvement Association* v. *Board of Permit Appeals*, 44 Cal. App. 3d 138, 118 Cal. Rptr. 490 (1st Dist. 1974), *appeal dismissed sub nom. Haas & Co., Inc.* v. *Russian Hill Improvement Association*, 422 U.S. 1030 (1975). Thus, a classification violates equal protection unless it is based on a real difference between the entities classified.

The classification of corporations into foreign and domestic categories and the further subclassifications of foreign insurance companies in the California retaliatory and premiums tax provisions are unreasonable. Because they are based upon no real or substantial difference, these classifications violate the equal protection clause. A corporation does not burden the State of California more heavily merely because it is incorporated out of state or because it occupies more or less than 75% of its principal California office building. As this Court noted in *Southern Railway, supra*:

> It would be a fanciful distinction to say that there is any real difference in the burden imposed because the one is taxed for the privilege of a foreign corporation to do business in the State and the other for the right to be a corporation. *The fact is that both corporations do the same business in character and kind,* and under the statute in question a foreign corporation may be taxed many thousands of dollars for the privilege of doing, within the State, exactly the same business as the domestic corporation is permitted to do by a tax upon its privilege, amounting to only a few hundred dollars. We hold, therefore, that to tax the foreign corporation for carrying on business under the circumstances shown, by a different and much more onerous rule than is used in taxing domestic corporations for the same privilege, is a denial of the equal protection of the laws, and the plaintiff being in position to invoke the protection of the Fourteenth Amendment, that such attempted taxation under a statute of the State, does violence to the Federal Constitution. 216 U.S. at 417-18. (Emphasis supplied.)

It is well established that classification based upon a corporation's state of incorporation violates the equal protection clause. In *Western Union Telegraph Co.* v. *Frear,* 216 F. 199 (W.D. Wis. 1914), a Wisconsin statute providing that any foreign corporation which exercised its right to remove a lawsuit to a federal court forfeited its license to do business within that state was held to violate the equal protection clause:

> Any attempt to substantially discriminate between domestic corporations and foreign corporations admitted to do business in a state, prejudicial to the latter, is invalid, whether it be by unequal taxation or other substantial inequality. *Id.* at 202.

*See also Power Manufacturing Co.* v. *Saunders,* 274 U.S. 490 (1927), in which this Court held that the venue statute

discriminating against foreign corporations violated the equal protection clause. Similarly, in *Herndon* v. *Chicago, Rock Island & Pac. Ry.*, 218 U.S. 135, 158-59 (1910), a Missouri statute requiring a foreign railway to forfeit its right to do business in Missouri if it resorted to a federal court was held unconstitutional.

In *Wheeling Steel Corp.* v. *Glander*, 337 U.S. 562 (1949), this Court examined an Ohio statute which governed the situs for taxation of intangible property, including accounts receivable. The statute provided that intangible property arising out of business transacted in Ohio by a non-resident was subject to taxation, whereas intangible property of a resident arising out of business transacted out of state was not subject to tax. In holding the statute violative of the equal protection clause, this Court noted:

> *It seems obvious that appellants are not accorded equal treatment, and the inequality is not because of the slightest difference in Ohio's relation to the decisive transaction, but solely because of the different residence of the owner. Id.* at 572. (Emphasis supplied.)

In *Reserve Life Insurance Co.* v. *Bowers*, 380 U.S. 258 (1965), *rev'g* 175 Ohio St. 468, 196 N.E.2d 87 (1964) this Court applied *Wheeling Steel* to strike down discriminatory taxation of a foreign life insurance company. Prior to 1960, Ohio levied a personal property tax on foreign insurance companies but exempted domestic insurance companies therefrom. The insurance company alleged that the law violated the equal protection clause of the Fourteenth Amendment. This Court, citing *Wheeling Steel* as authority, reversed the Ohio Supreme Court decision and held that the law was invalid.

More recently, this Court held that a New Jersey statute exempting domestic non-profit corporations from real and personal property taxes but not similarly exempting foreign non-profit corporations constituted an unconstitutional denial of equal protection of the laws. *WHYY* v. *Glassboro*, 393 U.S. 117 (1968) (*per curiam*). Thus, unless a state which unequal-

ly taxes foreign vis-a-vis domestic corporations can justify the disparity in treatment on grounds other than that they are residents of different states, the inequality is constitutionally impermissible.

In the instant case, the Board's denial of the full amount of the principal office deduction claimed by Western and Southern falls squarely within the holding of *WHYY, supra.* By amending Article XIII, section 14-4/5, subdivision (e) of its constitution and by enacting section 12241 of its Revenue and Taxation Code, California has deprived some foreign insurers, such as Western and Southern, of the full deduction retained for other foreign insurers and domestic insurers. Prior to 1966, all insurers, both foreign and domestic, were permitted to deduct from their gross premiums tax the amount of real estate taxes paid on account of their principal offices, regardless of whether the insurers leased space therein to others.

On November 8, 1966, the California constitution was amended to limit this deduction to a portion of the total taxes paid thereon if the taxpayer occupied less than 75% of the entire property. But this limitation did not apply to all insurers. A domestic insurer licensed to do business on or before December 31, 1966, which then owned a principal office in California or which, within the following three years, began construction of a California office was entitled to deduct the full amount of real estate taxes on its principal office, even if it occupied less than 75% of the entire building. Such provisions not only discriminate between domestic and foreign insurers but also discriminate among foreign insurers dependent on whether or not more than 25% of their offices are occupied by others. *See* Cal. Constitution, Art. XIII, § 14-4/5(e) (West Supp. 1976); Cal. Rev. and Tax. Code, § 12241 (West 1970). (Statutory Appendix, pp. 3a, 5a)

Even though Western and Southern was licensed to do business prior to December 31, 1966, and had constructed its principal office on real estate which it owned prior to January

1, 1970, it was denied the right to deduct the full amount of real estate taxes attributable to that building. Had Western and Southern been a domestic corporation or occupied at least 75% of the space, the full deduction would have been permitted. The Board can no more justify such inequality of treatment than could the taxing authorities in *WHYY, supra.* Western and Southern was subject to the same real estate tax rates as a domestic corporation; it paid these taxes to the same governmental unit as would have received payment from a domestic corporation. The only distinction upon which the inequality of treatment of Western and Southern and a California company is based is that Western and Southern is incorporated under the laws of Ohio rather than under the laws of California. Since this Court's decision in *Southern Railway, supra,* such a distinction is insufficient to justify discrimination. The additional distinction between foreign corporations obviously magnifies the constitutional violations.

Precisely the same logic applies to the issues raised by the assessment of the retaliatory taxes upon Western and Southern for the years 1965 through 1971. The only reason for the assessment of the tax is that Western and Southern is incorporated under the laws of another state. It is appropriate, furthermore, to consider the issues raised by the retaliatory tax in light of comments made by this Court in *Wheeling Steel, supra.*

In *Wheeling Steel,* the Tax Commissioner of the State of Ohio sought to justify the inequality in the taxing scheme involved by arguing that other states whose citizens were the victims of the discrimination could remedy the unfairness by adopting similarly discriminatory systems. This Court stated:

> The State does not seriously deny this unequal application of its own tax but claims that reciprocity provisions of the statute reestablish equality. Those provisions therefore require scrutiny.
>
> This entire taxing plan rests on a statutory formula for fixing situs of intangible property both within and with-

out the State. . . . These intangibles "shall be considered to arise out of business transacted *in a state other than that in which the owner resides*" under certain circumstances. [Emphasis supplied.] This basic rule separates the situs of intangibles from the residence of the owner whereas it has traditionally been at such residence, though with some exceptions. The effect is that intangibles of non-resident owners are assigned a situs within the taxing reach of Ohio while those of its residents are assigned a situs without. The plan may be said to be logically consistent in that, while it draws all such intangibles of non-residents within the taxing power of Ohio, it by the same formula excludes those of residents. The exempted intangibles of residents are offered up to the taxing power of other states which may embrace this doctrine of a tax situs separate from residence. This is what is meant here by reciprocity, and the two provisions are declared inseparable; so that if the formula by which Ohio takes unto itself the accounts of nonresidents is held invalid, "such decision shall be deemed also to affect such provision as applied to property of a resident."

It is hard to see that this offer of reciprocity restores to appellants any of the equality which the application of the Ohio tax, considered alone, so obviously denies. There is no indication of a readiness by other states to copy Ohio's situs scheme so as to tax that which Ohio exempts. The proffered exchange of residents for intangible tax purposes may not commend itself as an even bargain between states. Ohio, being large, populous and highly industralized, with heavy and basic industries, may well have much more to gain from a plan the effect of which is to tax credit exports to other states, than most states would have from a privilege to tax its own exports into Ohio. In the several years that the Ohio statute has been on the books, no other state has sought to take advantage of the "reciprocity" proffer. And if it did, the equality of rates which would also be necessary to equalize the burden between nonresidents and their resident competitors could be hardly expected nor is it provided for. 337 U.S. at 572-74.

It is no more plausible to justify California's assessment of a retaliatory tax with the argument that the State of Ohio may remedy the inequality by altering its system for the taxation of foreign insurers. Ohio has adopted a system of taxation which it deems to be desirable. Ohio's system may differ from that of California, but the California retaliatory tax must either stand or fall on its effects on insurers doing business within its borders. California cannot force its system on the State of Ohio in order to achieve "equality" any more than Ohio could force its system on the State of California in reversed circumstances. Further, what the Ohio legislature enacts is in no way the action of Western and Southern, and Western and Southern should not be penalized by the California legislature because of Ohio's statutes.

Western and Southern submits that both the comparative retaliatory tax and the denial of the principal office deduction in its full amount violate Section 1 of the Fourteenth Amendment to the Constitution.

## II. CALIFORNIA'S SYSTEM OF TAXING FOREIGN INSURANCE COMPANIES IMPOSES AN UNCONSTITUTIONAL BURDEN ON INTERSTATE COMMERCE.

There can be no question but that the California retaliatory tax discriminates against foreign insurance companies and their interstate business, and provides a direct commercial advantage to domestic insurance companies, i.e., to local business. It is obviously intended to have such effect. The trial court stated:

> This California tax is plainly discriminatory against interstate commerce. . . . It provides a direct commercial advantage to domestic business at the expense of out-of-state business. (JA p. 65)

The court's conclusions of law held in part:

> The California retaliatory tax as effective for the years 1965 and following discriminates against insurers from other states, including Ohio . . . . (JA p. 75)

The Court of Appeal of the State of California reversed the trial court, not because it found the California retaliatory tax provisions to be free from discrimination against foreign insurers, but because it believed that this Court, in *Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408 (1946) and *Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 822 (1946) had determined that such discrimination was sanctioned by the McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. §§ 1011-1015. The Court of Appeal was in error.

In 1944 this Court reversed its 76 year precedent, *Paul* v. *Virginia,* 75 U.S. (8 Wall.) 168 (1868), and held that an insurance company that conducted a substantial part of its business across state lines was engaged in interstate commerce. *United States* v. *South-Eastern Underwriters Association,* 322 U.S. 533 (1944).

To preserve state regulation of insurers from attacks based upon the commerce clause and to exempt the insurance business from certain parts of the anti-trust laws, Congress in 1945 enacted the McCarran Act. The Act declared that:

> . . . the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States. 15 U.S.C. § 1011 (1976).

Following *South-Eastern Underwriters* a series of test cases was commenced. Each insurer involved claimed that, notwithstanding the McCarran Act, the reversal of *Paul* v. *Virginia* required a finding that the commerce clause precluded a state from regulating a foreign insurer at all or from taxing it on a basis other than that of a domestic insurer. *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408 (1946); *Prudential Insurance Co.* v. *Hobbs*, 328 U.S. 822 (1946) (Kansas, involving 16 different insurance companies); *Prudential Insurance Co.* v. *Indiana*, 328 U.S. 823 (1946); *Robertson* v. *California*, 328 U.S. 440 (1946). None of these cases other than the Kansas case, *Hobbs*, involved a retaliatory tax statute.

*Hobbs* involved three Kansas taxes imposed on the foreign insurer: a firemen's relief fund tax, a premiums tax, and a retaliatory tax. As in the other cases, however, the sole contention made below in respect to each was that the commerce clause was violated and that *South-Eastern Underwriters* rendered prior decisions "obsolete". *In re Insurance Tax Cases*, 160 Kan. 300, 305, 161 P.2d 726, 731 (1945).

In its opinion, the Supreme Court of Kansas carefully pointed out that these laws were enacted prior to 1871, 160 Kan. at 303, 161 P.2d at 730, and significantly declared:

> When each of the plaintiffs was admitted to do business in this state it either specifically or in legal effect

> agreed to be bound by the laws of the state respecting its business. 160 Kan. at 309, 161 P.2d at 733.

Not a single company subject to the retaliatory tax had been admitted in Kansas prior to its enactment. The one insurer admitted in 1871 was shown not to have been subject to any retaliatory tax and to have agreed to be bound by the record of the others.

The Kansas Supreme Court provided its own syllabus of its decision, as follows:

1. Our statutes pertaining to insurance, G.S. 1935, 40-252, subd. B, 40-170, and G.S. 1943 Supp. 40-1702 and 40-173 were not rendered void by the decision of the Supreme Court of the United States in United States v. Southeastern Underwriters Ass'n, 322 U.S. 534, 64 S. Ct. 1162, 88 L.Ed. 1440.
2. Congress did not exceed its powers in passing Public Law No. 15 of the 79th Congress, first session, 15 U.S.C.A. § 1011 et seq.
3. Mandamus will not be allowed to compel an executive officer to do something contrary to a statute unless it is clear that the statute is void.

The memorandum opinion issued by this Court, *Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 822 (1946), could do no more than affirm the foregoing propositions of law. In affirming, this Court cited as authority the *Benjamin* opinion, issued one week earlier, in which this Court had cautioned:

> We express no opinion concerning the validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein. 328 U.S. at 431, n. 40.

This language expressly excluded approval of the retaliatory tax in *Hobbs,* for there was no retaliatory tax in South Carolina. Furthermore it should be noted that the Kansas Supreme Court was unable to find in the record before it any evidence that foreign insurers were taxed more heavily than domestic

insurers. 160 Kan. at 311, 161 P.2d at 734. Thus, even though retaliatory taxes were hypothetically before the Court in *Hobbs*, the blatantly discriminatory brand presented by the case at bar has never been expressly considered by this Court.

In *Benjamin*, this Court said that in enacting the McCarran Act Congress intended to give its full support to existing and future state systems for regulating and taxing the business of insurance, but "Congress had no purpose to validate unconstitutional provisions of state laws . . . ." 328 U.S. at 430. Further the Court pointed out that it did not intend to imply that the McCarran Act would exempt all state statutes regulating the insurance business from attack under the commerce clause. The Court noted at page 430:

> Nor is it necessary to conclude that Congress, by enacting the McCarran Act, sought to validate every existing state regulation or tax. For in all that mass of legislation must have lain some provisions which may have been subject to serious question *on the score of other constitutional limitations in addition to commerce clause objections* arising in the dormancy of Congress' power. And we agree with Prudential that there can be no inference that Congress intended to circumvent constitutional limitations on its own power. (Emphasis supplied.)

The trial court in this case expressed the same thought in its analysis of the limits of state authority in its Memorandum of Intended Decision. (JA pp. 61-63) Following *Benjamin*, the Court decided *Freeman* v. *Hewit*, 329 U.S. 249 (1946), specifically holding that the commerce clause itself inherently limits the legislative power of the states to discriminate against interstate commerce. *Id.* at 252.

In any event, this Court is the final arbiter of the meaning and effect of its prior decisions. Western and Southern believes that *Benjamin* and *Hobbs* were interpreted incorrectly by the California Court of Appeal. If, however, such belief is in error, Western and Southern urges a re-examination of these cases and a determination by this Court that the Mc-

Carran-Ferguson Act does not authorize discriminatory taxation against interstate commerce in denial of equal protection of the laws. As the Solicitor General stated in his brief for the United States as Amicus Curiae filed July 28, 1980, the Act should not be so construed. Citing the legislative history of the Act to the effect that the states were given no more powers than those they previously had, the Solicitor General said:

> . . . There is nothing explicit in the debate, the committee reports, or the statute that suggests that the states were given authority to erect barriers of economic protectionism. Insofar as state taxes were concerned, Congress was aware that current state revenues were in jeopardy of interruption, and intended to remove that hazard and uncertainty. Nothing suggests that Congress ever considered, or that the states were in fact given, enhanced authority to exclude, or to interfere with, competition by out-of-state insurers. And this Court's decisions under the McCarran-Ferguson Act have not in other respects construed the Act to sanction anticompetitive arrangements.[10] There is no reason why the tax provisions should be construed to permit anticompetitive taxation that discriminates against out-of-state insurers.

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[10] See, e.g., *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979); *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531 (1978).

In 1962 this Court held that state regulation and taxation of insurers must be maintained within the parameters of a trilogy of Supreme Court cases decided prior to the McCarran Act. *State Board of Insurance* v. *Todd Shipyards Corp.*, 370 U.S. 451 (1962). The Court relied upon the following legislative history of the Act to circumscribe state power:

> "It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the de-

> cision of the United States Supreme Court in the *Southeastern Underwriters Association case.* Briefly, your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States, subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as, for instance, in *Allgeyer* v. *Louisiana* (165 U.S. 578), *St. Louis Cotton Compress Co.* v. *Arkansas* (260 U.S. 346), and *Connecticut General Insurance Co.* v. *Johnson* (303 U.S. 77), which hold, inter alia, that a State does not have power to tax contracts of insurance or reinsurance entered into outside its jurisdiction by individuals or corporations resident or domiciled therein covering risks within the State or to regulate such transactions in any way." H. R. Rep. No. 143, 79th Cong., 1st Sess., p. 3. *Id.* at 455-56.

In the aforementioned cases, this Court expressly subjected state taxation and regulation of insurers to constitutional restraints imposed, *inter alia,* by the due process clause. *State Board of Insurance* v. *Todd Shipyards Corp., supra; People* v. *United National Life Insurance Co.,* 66 Cal.2d 577, 58 Cal. Rptr. 599, 427 P.2d 199, *appeal dismissed,* 389 U.S. 330 (1967).

While the commerce clause does not prohibit some state taxation of interstate insurance transactions, particularly in view of the stated congressional policy of the McCarran Act, both California's retaliatory tax and California's refusal to grant all foreign insurers the full principal office deduction constitute such substantial and unreasonable burdens on interstate commerce that they no longer can escape the commerce clause strictures.

The prohibition against discriminatory treatment of interstate commerce flows inexorably from the basic purpose of the commerce clause, to create an area of free trade among the several states. *Boston Stock Exchange* v. *State Tax Commission,* 429 U.S. 318, 328 (1977). To countenance state statutes such as the California retaliatory tax and prin-

cipal office deduction provisions that favor local enterprises at the expense of foreign corporations "would invite a multiplication of preferential trade areas destructive" of the free trade which the commerce clause protects. *See id.* at 329, *citing Dean Milk Company* v. *Madison*, 340 U.S. 349, 356 (1951).

In *Boston Stock Exchange* v. *State Tax Commission, supra*, this Court held that a New York statute imposing a greater transfer tax on out-of-state securities sales than on in-state securities sales violated the commerce clause. In so holding, the Court reaffirmed and strengthened earlier decisions holding free trade and open commerce between the states to be a basic guarantee of the commerce clause:

> [W]e begin with the principle that "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *McLeod* v. *J. E. Dilworth Co.*, 322 U.S. 327, 330 (1944). It is now established beyond dispute that "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States. . . . [T]he Commerce Clause even without implementing legislation by Congress is a limitation on the power of the States." *Freeman* v. *Hewit*, 329 U.S. 249, 252 (1946). 429 U.S. at 317.

In declaring the New York statute violative of the commerce clause, the Supreme Court cited *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), a price regulation case in which it was held that the commerce clause prohibits obstructions to competition between the states, even when such obstructions are sought to be justified as measures to assure the economic health of local industry. The Court found Justice Cardozo's opinion in *Baldwin* "particularly relevant" inasmuch as it expressly rejected the argument that obstructions to competition in interstate commerce may be justified as assurances of the health of local industry:

> The Constitution was framed . . . upon the theory that the peoples of the several states must sink or swim together,

and that in the long run prosperity and salvation are in union and not division. 429 U.S. at 335-36 (citing *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511, 522-23 (1935)).

The constitutional infirmity of California's retaliatory tax is patent. By definition, the tax applies only to some and not all foreign insurance companies doing business in California. On its face it discriminates against the companies of some of California's sister states. Moreover, the tax lacks even a vestige of a legitimate purpose. Prior to the 1964 constitutional amendment, the tax bore a semblance of justification in that it operated only against foreign insurers whose states of incorporation (without regard to the retaliatory tax statutes of such states) taxed California insurers and other foreign insurers doing business therein on a less favorable basis than applicable to their domestic insurers. Subsequent to the amendment, however, no semblance of justification remains. Even if the home state of the foreign insurer taxes both its domestic and foreign insurers generally on an equal footing, without regard to retaliation, California would impose a punitive retaliatory tax upon a foreign insurer from such state doing business in California if the foreign insurer's state would tax a hypothetical California insurer doing business therein an amount which exceeds California's taxes on the foreign insurer doing business in California. California's retaliatory tax falls short of the substantially evenhanded treatment required by the commerce clause.

It may well be that California's comparative retaliatory tax was enacted, not for the purpose of raising revenue, but for the purpose of inducing other states not to levy higher taxes on insurance business than California levies. But as is evident here, when the State of Ohio did not accept the invitation of California and laid a heavier burden on insurance companies than California did, the direct result in the years involved was the raising of $977,853.53 in additional taxes from Western and Southern. Sixteen states in addition to Ohio levy

premium taxes on foreign insurance companies at rates higher than California's 2.35% rate.[4]

The constitutionality of one state's statutes affecting nonresidents cannot depend upon the present configuration of the statutes of another state. *Austin* v. *New Hampshire,* 420 U.S. 656 (1975). The fact that Ohio possibly could shield its resident (domestic) insurers from California's retaliatory tax by decreasing the aggregate taxes on foreign insurers generally does not salvage California's retaliatory tax provisions.[5] In fact, the discrimination is compounded, rather than cured, by retaliation. *Id.* at 666-67. California's retaliation invites counter-retaliation by the Ohio legislature and by all other states; it perpetuates and strengthens the preferential trade areas which the commerce clause was intended to eliminate.

California's purported justification of the retaliatory tax as a measure to assure the economic strength of its domestic insurers in foreign states does not withstand scrutiny. Because

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[4] Alabama: 3.0%, Code of Alabama, § 27-44 (1975); Alaska: 3.0%, Alaska Statutes, § 21.09.210 (1966); Arkansas: 2.5%, Arkansas Statutes, § 66-2302 (1979); Hawaii: 3.197%, Hawaii Revised Statutes, § 431-318 (1978); Idaho: 3.0%, Idaho Code, § 41-402 (1977); Mississippi: 3.0%, § 27-15-103 (1977); Montana: 2.75%, Montana Code Annotated, § 33-2-706 (1978); New Mexico: 2.5%, New Mexico Statute Annotated 1978, § 59-5-1 (1979); North Carolina: 2.5%, General Statute of North Carolina, § 105-228.5 (1974); North Dakota: 2.5%, North Dakota Century Code, § 26-01-11 (1979); Oklahoma: 4.0%, Oklahoma Statutes, § 36-6-624 (1979); South Carolina: 3.0%, Code of Laws of South Carolina, § 38-5-320 (1980); South Dakota: 2.5%, South Dakota Codified Laws, § 10-44-2 (1980); Texas: 3.3%, Vernon's Annot. Civil Statutes/Insurance Code Title 78, Art. 4769 (1957); West Virginia: 3.0%, West Virginia Code, § 33-3-14 and § 33-3-14a (1961); Wyoming: 2.5%, Wyoming Statutes, § 26-4-103 (1977).

[5] If Ohio were to reduce its tax on foreign insurers but not on domestic insurers, its domestic insurers might avoid the imposition of retaliatory taxes under either an anti-discrimination or a comparative retaliatory tax statute, but this could well constitute reverse discrimination in Ohio against domestic insurers, as repugnant as the discrimination resulting from California's retaliatory tax provisions.

the tax directly obstructs interstate competition and substantially disrupts the equilibrium of free trade among the states, it violates the commerce clause.

## CONCLUSION

Each of the grounds advanced herein independently supports Western and Southern's right to reversal of the Court of Appeal's decision, as the trial court found originally. (Memorandum of Intended Decision, JA, p. 57) Western and Southern was admitted for an unlimited term to do business in California. It was entitled to the equal protection and due process guarantees of the United States and California constitutions. The discriminatory tax treatment imposed upon Western and Southern with respect to the California retaliatory tax provisions and the denial of the credit for the full amount of real estate taxes on the principal office is predicated upon no substantial difference in law or in fact between foreign and domestic corporations. Accordingly, the subject tax provisions as applied to Western and Southern violate Section 8, clause 3, of Article I and Section 1 of the Fourteenth Amendment of the United States Constitution.

The judgment of the Court of Appeal of the State of California, Second Appellate District, should be reversed, and the judgment of the Superior Court of California for the County of Los Angeles should be reinstated.

Respectfully submitted,

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November 14, 1980

## STATUTORY APPENDIX

United States Constitution, Article I, Sec. 8, Clause 3:

> The Congress shall have Power . . . [cl. 3] To regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes; . . .

United States Constitution, Amend. XIV, Sec. 1:

> Section 1
>
> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

### McCARRAN-FERGUSON INSURANCE REGULATION ACT, 15 U.S.C. § 1011-1015:

**§ 1011. Declaration of policy**

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

**§ 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948**

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

**§ 1013. Suspension until June 30, 1948, of application of certain Federal laws; Sherman Antitrust Act applicable to agreements to, or acts of, boycott, coercion, or intimidation**

(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

**§ 1014. Applicability of National Labor Relations Act and Fair Labor Standards Act of 1938**

Nothing contained in this chapter shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

**§ 1015. Definition of "State"**

As used in this chapter, the term "State" includes the several States, Alaska, Hawaii, Puerto Rico, Guam, and the District of Columbia.

**California Constitution, Article XIII, § 14-4/5(e):**

Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this State. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

Where as a result of merger, consolidation, or other method of acquisition of substantially all of the assets of one or more insurers by another insurer, effected prior to January 1, 1939, an insurer owns more than one parcel of real property in this State in which was located a home office or principal office of an insurer immediately prior to such acquisition, the owner shall designate one of such properties as its home or principal office. Real estate taxes paid by it in any of the years 1943 to 1952, inclusive, before, or within 30 days after, becoming delinquent, on such property owned by it at the time of payment and not so designated may also be deducted from the annual tax imposed by this section in respect to such year and are included within the deduction provided for in this subdivision.

**California Constitution, Article XIII, § 14-4/5(f):**

The tax imposed on insurers by this section is in lieu of all other taxes and licenses, state, county, and municipal, upon such insurers and their property, except:

(1) Taxes upon their real estate.

(2) That an insurer transacting title insurance in this State which has a trust department or does a trust business under the banking laws of this State is subject to taxation with respect to such trust department or trust business to the same extent and in the same manner as trust companies and the trust departments of banks doing business in this State.

(3) When by the laws of any other state or country any taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations or prohibitions are imposed on insurers of this State doing business in such other state or country, or upon their agents therein, in excess of those imposed upon insurers of such other state or country or upon their agents therein, so long as such laws continue in force, the same obligations and prohibitions of whatsoever kind may be imposed by the Legislature upon insurers of such other state or country doing business in this State, or upon their agents herein.

(4) The tax on ocean marine insurance.

(5) Motor vehicle and other vehicle registration license fees and any other tax or license fee imposed by the State upon vehicles, motor vehicles or the operation thereof.

**California Insurance Code, § 685:**

**Imposition of retaliatory taxes, licenses, fees, fines, penalties or deposit requirements.**

When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in ex-

cess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this State, so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this article. (Added by Stats. 1959, c. 2120, p. 4945, § 1.)

**California Revenue and Taxation Code, § 12241:**

**Real estate taxes on principal office realty**

(a) Each insurer shall have the right to deduct from the tax imposed by this chapter upon an insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for convenient use and occupation thereof.

(b) In the event a portion of the real property described in subdivision (a) is occupied by a person or persons other

than the insurer the deduction granted the insurer by said subdivision shall be limited to that percentage not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this section, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(c) The phrase "person or persons other than the insurer" as used in subdivision (b) of this section shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities.

(Added by Stats, 1961, c. 740, p. 1983, § 28, operative Jan. 1, 1962. Amended by Stats, 1967, c. 1007, p. 2600, § 4.)

**California Revenue and Taxation Code, § 12284:**

**Assessment; notice.**

Annually, on or before September 15th, the board shall assess in respect to the preceding calendar year, the retaliatory taxes imposed upon insurers, giving consideration to the recommendations of the Insurance Commissioner. Immediately after making the assessment of retaliatory tax against an

insurer, the board shall give notice of the assessment to the insurer at its address as it appears in the records of the board. The board shall transmit copies of the notice to the Insurance Commissioner and the Controller.

(Added by Stats. 1961, c. 44, p. 985, § 1, eff. March 31, 1961.)

**California Revenue and Taxation Code, § 13102:**

**Necessity of claim for refund or credit.**

No suit or proceeding shall be maintained in any court for the recovery of any amount alleged to have been erroneously or illegally assessed or collected unless a claim for refund or credit has been duly filed in accordance with Article 2 of Chapter 7 of this part.[1]

(Added by Stats. 1961, c. 740, p. 1992, § 70, operative Jan. 1, 1962.)

**California Revenue and Taxation Code, § 13103:**

**Action against board after notice of board's action on claim for refund or credit.**

Within 90 days after the mailing of the notice of the board's action upon a claim for refund or credit, the claimant may bring an action against the board on the grounds set forth in the claim in a court of competent jurisdiction in any county or city and county in the State in which the Attorney General has an office for the recovery of the whole or any part of the amount with respect to which the claim has been disallowed. The Attorney General shall defend the action.
(Added by Stats. 1961, c. 740, p. 1992, § 72, operative Jan. 1, 1962.)

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[1] Section 12977 et seq.

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No. 79-1423

# In the Supreme Court of the United States

OCTOBER TERM, 1980

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,
*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
*Appellee.*

On Appeal from the Court of Appeal,
Second Appellate District, State of California

## Brief of the Appellee

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## QUESTIONS PRESENTED

1. Should this Court now overrule *Prudential Ins. Co. v. Benjamin* (1946) 328 U.S. 408, wherein this Court held that Congress had the power to, and in the McCarran-Ferguson Act did, completely release the states from all commerce clause restraints upon the regulation and taxation of interstate insurance business, and *Prudential Ins. Co. v. Hobbs* (1946) 328 U.S. 822 (per curiam), wherein this Court applied the *Benjamin* holding to defeat a commerce clause challenge to a comparative insurance retaliatory tax which is substantially identical to the California retaliatory tax being challenged herein by appellant?

2. Is there any violation of the equal protection or due process guaranties of the United States Constitution by the application to appellant of the California comparative retaliatory insurance tax, which was enacted to secure uniformity and reciprocity among the states and which separately classifies each insurer by imposing upon said insurer the same higher tax burden (if any) as that insurer's home state would impose upon a similar California insurer?

3. Does the California holding that the constitutional validity of the gross premiums tax principal office deduction need not be determined in this case (because under California's insurance taxation structure any increase to appellants' gross premiums tax principal office deduction would automatically be balanced by an increase in its retaliatory tax liability) provide an adequate state ground which prevents this Court from having jurisdiction to consider appellant's challenge of the validity of the gross premiums tax principal office deduction?

4. If the retaliatory tax were held by this Court to be constitutionally invalid, then should the validity of the gross premiums tax principal office deduction (as amended in 1966

and repealed in 1976) be first determined on appeal by this Court without any remand to the California appellate courts; if so, was there any violation of the commerce clause or the equal protection or due process guaranties of the United States Constitution by the principal office deduction from the California gross premiums privilege tax, whereby some foreign (out-of-state) insurers did not get the same extent of the privilege tax deduction as their California counterparts?

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# In the Supreme Court of the United States

OCTOBER TERM, 1980

**No. 79-1423**

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,
*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
*Appellee.*

On Appeal from the Court of Appeal,
Second Appellate District, State of California

## Brief of the Appellee

### OPINIONS BELOW

The opinions below are correctly referenced by The Western and Southern Life Insurance Company (hereinafter "Western and Southern") on pages 1 and 2 of appellant's brief, except that the California Court of Appeal's opinion reported at 99 Cal.App.3d 410 and 159 Cal. Rptr. 539 is now reported with the November 28, 1979 modifications included. Also, in the Joint Appendix (J.A. 88-89) the bracketed references inserted in the Court of Appeal's order of November 28, 1979 are to pages in Western and Southern's jurisdictional statement rather than to the opinion as printed in the Joint Appendix.

## GROUNDS FOR JURISDICTION

In its grounds for jurisdiction, Western and Southern incorrectly states (W. & S. 3)[1] that the California Court of Appeal expressly held that the principal office deduction provided by then article XIII, section 14-4/5(e) of the California Constitution and by California Revenue and Taxation Code section 12241 did not violate the United States Constitution. To the contrary, after finding the retaliatory tax to be constitutional, the Court of Appeal found it unnecessary to determine the constitutionality of the principal office deduction because of the interrelated nature of the California retaliatory and gross premiums taxes. J.A. 86-87, 89.

## CONSTITUTIONAL AND STATUTORY PROVISIONS

With the exception of California Insurance Code sections 685.1 through 685.4, Western and Southern cites (W. & S. 4) the statutes and constitutional provisions which are involved in this case. However, its statutory appendix (W. & S. 1a-7a) contains several major errors as to the contents of the California constitutional provisions; therefore appellee State Board of Equalization is attaching its own statutory appendix (Appendix A) hereto in which the California provisions are properly set forth.

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1. Citations herein will be made in the following forms:
   (a) Brief for appellant Western and Southern: "W. & S."
   (b) *Amicus curiae* brief filed by the United States Solicitor General: "U.S."
   (c) *Amicus curiae* brief filed by the Life Insurance Council of New York (referred to herein as "LICONY"): "LICONY"
   (d) *Amicus curiae* brief for the State of New York: "N.Y."
   (e) Joint Appendix: "J.A."

## STATEMENT OF THE CASE

This case involves the California tax provisions regarding insurance companies doing insurance business in California, including the California retaliatory tax for the years 1965 through 1971 (Cal. Const., art. XIII, former § 14-4/5, subd. f(3) and Cal. Ins. Code §§ 685-685.4) and the principal office deduction from the California gross premiums tax for the years 1967 through 1971 (Cal. Const., art. XIII, former § 14-4/5, subd. (e); former Cal. Rev. & Tax. Code § 12241). The California retaliatory tax provisions can be summarized as providing that when a foreign state would impose a heavier tax burden upon a California insurer than California would normally impose upon a similar insurer from that foreign state, then California will instead impose the same tax burden on that state's insurer as would be imposed by that state upon the similar California insurer. This is what is known as a "comparative" retaliatory tax; all of the 49 states which have retaliatory insurance tax statutes have comparative statutes. See below at p. 33 and Appendix B hereto.[2]

In determining appellant Western and Southern's retaliatory tax liabilities for each year in the case at bar, appellee State Board of Equalization (hereinafter "the Board") first determined the insurance premiums taxes and fees which Ohio (Western and Southern's home state) would have imposed on a similar California insurer transacting the same kind and amount of insurance business in Ohio that

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2. Before a 1964 amendment to the California constitutional provision, the California Constitution (but not the statute) had provided as an additional condition for the application of the retaliatory tax that the foreign state would actively discriminate by imposing upon the California insurer burdens exceeding those which it imposed upon its similar domestic insurer. *See Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 4-6, 62 Cal. Rptr. 784, 786-87 (hearing denied, Cal. Sup. Ct.)

Western and Southern actually transacted in California. Since the resulting Ohio figures were greater than the premiums taxes and fees owed by Western and Southern to California, the difference between those amounts was imposed as the California retaliatory tax under the terms of Insurance Code section 685 and California Constitution, article XIII, section 14-4/5, subdivision (f)(3) as amended in 1964.

California also imposes a gross premiums tax upon all insurers doing business in California; this is a privilege tax measured by the amount of gross premiums, less return premiums, received during the year by the insurer from its California business. During the years at issue said tax had a principal office deduction whereby an insurer could deduct from the premiums tax otherwise due the amount of certain real estate taxes which it had paid during the year upon real property containing its California principal office. Cal. Const., art. XIII, former § 14-4/5, subd. (e) as amended in 1966; Cal. Rev. & Tax. Code § 12241 as amended in 1967.[3] Western and Southern has challenged the constitutional validity of the principal office deduction for the years in issue on the basis of a distinction made therein between some California insurers and other insurers.

In the decision which is on appeal the California Court of Appeal, reversing a trial court decision (J.A. 55-79) in favor of Western and Southern, held that the California comparative retaliatory tax is constitutionally valid. J. A. 82-86. It further held that it did not need to reach the federal constitutional issues regarding the principal office deduction, for under California law the gross premiums tax and the retaliatory tax "are but parts of a single taxation

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3. The entire principal office deduction was repealed in 1976. See Appendix A for the text of the cited provisions.

scheme," wherein no tax refund is due unless the taxpayer has paid more than the total scheme required. J.A. 86-87, 89. Since the burden which Ohio would impose upon a similar California insurer would be greater than California's non-retaliatory tax burden on Western and Southern, any gross premiums tax reduction Western and Southern might gain on its principal office deduction issue would be offset automatically under California law by an increase in its retaliatory tax liabilities. *Id.* Because of this result under California law the Court of Appeal did not decide the principal office deduction issues raised by Western and Southern.

On December 27, 1979, the California Supreme Court denied Western and Southern's request for hearing in this case. J.A. 89.

## SUMMARY OF ARGUMENT

It makes no difference in this case that the California laws now challenged by Western and Southern became effective after Western and Southern was given its California license for an indefinite term (which license was specifically conditioned upon conformance with present and future California laws). State laws must conform to the United States Constitution whether they are being applied to a corporation already doing business in the state or are imposed as a condition of entry or as a condition for a renewal of a license, for the Constitution is no longer construed as permitting states to require corporations to forfeit constitutional rights as a condition of being admitted to do business.

In *Prudential Ins. Co. v. Benjamin* (1946) 328 U.S. 408, this Court held that Congress had the power to, and in the McCarran-Ferguson Act did, completely release the states from all commerce clause restraints upon the regulation and taxation of interstate insurance business, which this

Court had held in 1944 to be interstate commerce. In applying the McCarran-Ferguson Act the *Benjamin* holding specifically exempted from commerce clause restraints a state tax which this Court explicitly assumed to be discriminatory as to insurers from outside the taxing state. Congress has never indicated dissatisfaction with the *Benjamin* decision; recent decisions of this Court are fully supportive of its holdings.

In *Prudential Ins. Co. v. Hobbs* (1946) 328 U.S. 822 this Court applied the *Benjamin* case in a *per curiam* opinion to uphold a Kansas comparative retaliatory insurance tax against an attack made in the name of the commerce clause. Since the Kansas statute was substantially identical to the California retaliatory tax being challenged by Western and Southern, the *Hobbs* decision, supported by the principles enunciated in *Benjamin,* applies here to defeat Western and Southern's commerce clause attack on the California retaliatory tax.

There is no equal protection violation arising from the application of the California retaliatory tax to Western and Southern. The retaliatory tax satisfies established equal protection standards by having valid legislative objects and by using a classification which is reasonably related to those legislative objects. *See Allied Stores of Ohio v. Bowers* (1959) 358 U.S. 522, 526-27. Any revenue raised by the retaliatory tax is purely incidental; objectives of the retaliatory tax are to foster the California insurance industry by encouraging evenhanded tax treatment by other states and to induce relative uniformity of state insurance tax burdens nationwide so as to encourage interstate insurance business. These purposes are advanced by classifying each insurer by the way its home state would treat a similar California insurer: the amount of the retaliatory tax as to each insurer is set and is reducible in a

purely reciprocal manner, depending on the current law of that insurer's home state; if that state would place a burden on a similar California insurer that is no greater than California's basic privilege tax burdens on the insurer in question, there is no California retaliatory tax due. This method of classification is fully consistent with this Court's equal protection decisions which allow greater burdens to be imposed on nonresidents if that classification rests on a reasonable basis other than just nonresidency *per se*. *See*, e.g., *Baldwin v. Montana Fish and Game Comm'n* (1978) 436 U.S. 371, 388-90; *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, 810-14; *Metropolitan Co. v. Brownell* (1935) 294 U.S. 580, 582-86.

The purpose of the retaliatory tax law and its method of operation are supportive of any element of federalism within the equal protection clause, for the form of retaliatory tax adopted by almost every state encourages reciprocity between the states and results both in relatively uniform insurance tax burdens nationwide and in an effective restraint upon increases in those burdens. The California Legislature had and continues to have more than adequate support for the legislative assumptions which form the basis of the retaliatory tax law.

Given the validity of the retaliatory tax, the California Court of Appeal did not reach the issue of validity of the 1966 amendment to the principal office deduction which was a part of the California gross premiums privilege tax law until that deduction was repealed in 1976. The issue was not decided because under California law the gross premiums tax and the retaliatory tax are but interrelated parts of a single insurance taxation structure, so that any increase in Western and Southern's gross premiums tax principal office deduction would automatically be balanced

by an increase in its retaliatory tax liability. This basis forms an adequate and independent state ground which prevents this Court from having jurisdiction to consider appellant's challenge of the validity of the gross premiums tax principal office deduction. If this Court were to hold the retaliatory tax to be invalid, then this would be an appropriate case to remand to the California appellate courts for the first appellate determination of the validity of the principal office deduction. In any event, should this Court consider the principal office deduction issue, it is clear that the McCarran-Ferguson Act removes the possibility of commerce clause application and that the deduction, being part of a privilege tax law, did not violate equal protection standards by giving some foreign (out-of-state) insurers less of a deduction than their California counterparts. *See Cheney Bros. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494, 510-12, 514-15.

## ARGUMENT

### I. THE FACT THAT CALIFORNIA HAS GIVEN WESTERN AND SOUTHERN A LICENSE (WHICH WAS EXPRESSLY CONDITIONED ON CONFORMANCE WITH PRESENT AND FUTURE CALIFORNIA LAWS AND REQUIREMENTS) FOR AN INDEFINITE TERM DOES NOT AFFECT THE VALIDITY OF CALIFORNIA'S IMPOSITION OF THE TAX PROVISIONS INVOLVED IN THIS CASE.

Appellant Western and Southern and *amici curiae* in support of Western and Southern stress that California gave Western and Southern a license of an indefinite term before California reimposed its retaliatory tax in 1959 and before California amended its principal office deduction to the California gross premiums privilege tax. W. & S. 4, 8, 14-17, 33; U.S. 3, 9-10; LICONY 3, 6-7, 18; N.Y. 5. As recognized by Western and Southern (W. & S. 17),

the license itself (J.A. 43) was expressly conditioned upon Western and Southern's compliance with the California laws and lawful requirements as they then existed or might thereafter be changed or amended.

Appellee Board of Equalization does not claim that California has or ever had the power to impose unconstitutional conditions upon Western and Southern as a part of California's licensing process. Unless such a power existed at the time of admission, it makes absolutely no difference that California has given Western and Southern a license for an indefinite term.

Commerce clause considerations aside, now outdated nineteenth century authorities would provide clear support for the proposition that since a state can completely exclude a corporation, it can impose any conditions upon admission at the time of admission, even if those conditions would violate the Constitution if they were imposed after admission was granted to do business in the state. *See Pembina Mining Co. v. Pennsylvania* (1888) 125 U.S. 181, 188-90. However, in this century this Court has made clear the doctrine of unconstitutional conditions, whereby a corporation may *not* be required to give up its constitutional rights as a condition of admission to do business in a state. *Baltic Mining Co. v. Massachusetts* (1913) 231 U.S. 68, 83; *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494, 507-08;[4]

4. Contrary to Western and Southern's characterization (W. & S. 15-16), the *Hanover Insurance Co.* opinion recognized that a state's power to impose conditions upon a corporation's *admission* was qualified by the requirement of the more modern decisions that the state's conditions could not require forfeiture of rights guaranteed by the United States Constitution. 272 U.S. at 507. *Hanover* was cited for this very point in *Lincoln Life Ins. Co. v. Read* (1945) 325 U.S. 673, 677, which is also cited by Western and Southern (W. & S. 17).

*Power Co. v. Saunders* (1927) 274 U.S. 490, 496-97; *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562, 571.

Thus the nineteenth century approach no longer applies. *Southern Railway Co. v. Greene* (1910) 216 U.S. 400, which is relied upon by Western and Southern (W. & S. 8, 14-15) is but an example of the old line of cases which was rendered obsolete by such subsequent cases as those just cited above. A corporation may not be required to give up its constitutional rights as a condition of entry into a state. Except for the state's right to bar them completely, corporations seeking entry into a state stand on the same footing as corporations already authorized to do business therein.

It follows that, in the case at bar, if the California retaliatory tax as amended in 1964 and the principal office deduction as amended in 1966 could have been constitutionally applied to a foreign insurer[5] as conditions of being first admitted in 1967 to do business in California, they can be constitutionally applied to Western and Southern. Given the express conditions in Western and Southern's California certificate (J.A. 43) which make it clear that all constitutional amendments to California law will apply to Western and Southern, Western and Southern is in no better position in this case than if it were initially seeking application to do business in California or if it were applying for an annual renewal of its license.

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5. In this brief the term "foreign insurer" refers to an insurer domiciled in any state other than the taxing jurisdiction in question.

## II. THE CALIFORNIA COMPARATIVE RETALIATORY TAX ON INSURERS IS CONSTITUTIONAL.

### A. Due to the Federal McCarran-Ferguson Act, the California Insurance Retaliatory Tax Is Exempt from Commerce Clause Requirements; Said Tax Cannot Be Violative of Commerce Clause Requirements.

#### 1. CONGRESS HAS THE POWER TO RELEASE ALL STATE TAXATION, DISCRIMINATORY OR NOT, OF INTERSTATE INSURANCE BUSINESS FROM COMMERCE CLAUSE RESTRAINTS.

In *Prudential Ins. Co. v. Benjamin* (1946) 328 U.S. 408, this Court considered and forcefully rejected essentially the same argument that is now presented by appellant Western and Southern: that by the McCarran-Ferguson Act (15 U.S.C. §§ 1011-1015) Congress could not and did not release all state taxation of insurance business from commerce clause restraints.[6] In *Benjamin* the Prudential Insurance Company argued that, no matter what Congress did or did not do, the commerce clause " 'of its own force' . . . forbids discriminatory state taxation of interstate commerce." *Id.* at 422. This Court rejected this contention and held to the contrary as follows:

> "The commerce clause is in no sense a limitation upon the power of Congress over interstate and foreign commerce. On the contrary, it is, as Marshall declared

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6. The McCarran-Ferguson Act was Congress' response to this Court's decision in *United States v. South-Eastern Underwriters Assn.* (1944) 322 U.S. 533, which ended seventy-five years of precedent, starting with *Paul v. Virginia* (1869) 8 Wall. 168, in which insurance was held to not be interstate commerce and thus not subject to commerce clause restraints. The McCarran-Ferguson Act responded to a threatened breakdown of state insurance taxation and regulation which arose in the wake of *South-Eastern Underwriters. Group Life & Health Ins. Co. v. Royal Drug Co.* (1979) 440 U.S. 205, 217-19 & nn. 15-18.

> in *Gibbons v. Ogden,* a grant to Congress of plenary and supreme authority over those subjects. The only limitation it places upon Congress' power is in respect to what constitutes commerce, including whatever rightly may be found to affect it sufficiently to make congressional regulation necessary or appropriate." 328 U.S. at 423 (footnote omitted).

Thus Congress has the power to completely release the states from *all* commerce clause restraints upon the regulation and taxation of the interstate insurance business which this Court (in *United States v. South-Eastern Underwriters Assn.* (1944) 322 U.S. 533) had held to be interstate commerce.

**2. IN THE McCARRAN-FERGUSON ACT CONGRESS EXERCISED ITS POWER TO RELEASE ALL STATE TAXATION OF INSURANCE BUSINESS FROM COMMERCE CLAUSE RESTRAINTS.**

Contrary to the contentions of Western and Southern (W. & S. 27) and the Solicitor General (U.S. 17-18), in *Prudential Insurance Co. v. Benjamin* this Court held that in the McCarran-Ferguson Act Congress exercised its commerce clause power so as to free *all* state taxation, discriminatory or not, of insurance business from commerce clause attack. In *Benjamin* this Court was concerned with a South Carolina situation where a gross premiums tax was imposed on out-of-state insurers but *no* such tax was required of South Carolina insurers. *Id.* at 410-11. This Court made its decision on a stated *assumption* that the South Carolina tax was discriminatory against interstate commerce. 328 U.S. at 429.[7] Due to the clarity of the McCarran-

7. The Solicitor General fails to mention this stated assumption; instead the Solicitor General makes the misleading statement that "[i]t was not established that the South Carolina tax in issue was in fact discriminatory, and the Court refrained from addressing that question (*id* at 428)." U.S. 17.

Ferguson Act, this Court stated that it was "not necessary to spend much time with interpreting the McCarran Act." *Id.* After quoting the pertinent provisions,[8] this Court stated that "[o]bviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance." *Id.* As to the commerce clause, this Court, still operating under the assumption that it was dealing with a discriminatory tax, held that Congress in the McCarran-Ferguson Act

> "clearly put the *full weight of its power* behind existing and future state legislation to sustain it from *any* attack under the commerce clause to whatever extent this can be done with the force of that power behind it, subject only to the exceptions expressly provided for [in the act]." *Id.* at 431 (emphasis added).

It has already been established (above pp. 11-12) that said power of Congress was complete; it follows that *Prudential Ins. Co. v. Benjamin* is as clear as case authority can be that by the McCarran-Ferguson Act Congress exercised its power to release all state taxation, discriminatory or not, of insurance business from commerce clause restraints.

The contrary contentions of Western and Southern and the Solicitor General are easily answered. Contrary to the clear holdings of the *Benjamin* case, Western and Southern

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8. "'. . . the Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

'SEC. 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

'(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . . .' 59 Stat. 33, 34; 15 U.S.C. §§ 1011-1015." *Id.* (footnote omitted).

claims (W. & S. 11-12, 27) that this Court indicated in *Benjamin* that its commerce clause holding did not necessarily exempt all state statutes regulating interstate insurance business from commerce clause attack; however, the passage relied upon by Western and Southern refers to the possible existence of state statutes that "may have been subject to serious question on the score of *other* constitutional limitations *in addition to* commerce clause objections arising in the *dormancy* of Congress' power." *Id.* at 430 (emphasis added). This statement was made in the context of the Court's recognition that Congress did not intend to circumvent constitutional limitations on its own power by attempting to validate every state regulation or tax as against all other types of constitutional attack; the statement is fully consistent with the holdings, recited above, that once Congress' power regarding the commerce clause was no longer dormant but had been exercised (as it was in the McCarran-Ferguson Act) so as to exempt all state regulation and taxation of interstate insurance business, there was no further restraint arising from the commerce clause to restrict state taxation of insurance business even when that taxation was discriminatory as to interstate commerce.[9]

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9. Western and Southern (W. & S. 26) and the Solicitor General (U.S. 17-18) also try to limit the *Benjamin* holding by referring to this Court's statement (*id.* at 431-32 n. 40) regarding certain statutes of other states. Footnote 40 of this Court's opinion cited statutes of sixteen other states which were "substantially similar" to the South Carolina tax. Apparently because this Court held that the South Carolina statute was consistent with other constitutional limitations as well as being immune from commerce clause attack (*id.* at 436, 437-38), this Court found it prudent to follow the citation of the sixteen other state statutes with a disclaimer "concerning the validity of any feature of the statutes not substantially identical with those of the South Carolina tax dealt with herein." *Id.* at 432 n. 40. That statement is consistent with the all-encompassing *Benjamin* holdings regarding the lack of *commerce clause* restraints on state taxation of insurance business after the enactment of the McCarran-Ferguson Act.

The Solicitor General tries to bring state retaliatory taxes on interstate insurance business out of the scope of the *Benjamin* decision by using such characterizations as "barriers of economic protectionism" (U.S. 16), "anticompetitive arrangements" (U.S. 16), and "statutory protectionism" (U.S. 18); the use of these labels cannot circumvent the fact that in *Benjamin* this Court clearly held that a state tax on insurance business that was discriminatory as to interstate commerce would be exempted by the McCarran-Ferguson Act from all commerce clause attack. For the same reason there is no basis for the Solicitor General's remark that there is no reason to construe the McCarran-Ferguson Act to permit "anti-competitive state taxation that discriminates against out-of-state insurers." U.S. 16.[10]

Given the commerce clause power of Congress and the broad scope of Congress' exercise of said power in the

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10. In making this remark the Solicitor General apparently means to refer to retaliatory taxes such as the one in issue. It should be pointed out that at the time of the McCarran-Ferguson Act retaliatory taxes had long been applied to insurance companies; in fact the constitutional validity of such a statute was before this Court in *Phila. Fire Association v. New York* (1886) 119 U.S. 110. See below at p. 21 n. 17. Thus the Solicitor General has no basis for his implied contention that taxes such as retaliatory taxes "had never been countenanced prior to the *South-Eastern Underwriters* decision . . . ." U.S. 16. Before *South-Eastern* there would have been no question under the commerce clause regarding the insurance taxation involved in this case; therefore appellee Board's position as to the commerce clause cannot be hurt by the Solicitor General's contention (U.S. 15-16) that the McCarran-Ferguson Act was only meant to reestablish what the state of the law had been before *South-Eastern* so as to remove the hazard to current state revenues. Also see W. & S. 28. Indeed, it is reported that after the *South-Eastern* decision fourteen states immediately repealed their retaliatory laws. Pelletier, "Insurance Retaliatory Laws", 39 Notre Dame Lawyer 243, 249 (1964). California was one such state; it repealed its retaliatory statute in 1945 (Cal. Stats. 1945, ch. 921, § 1, p. 1716) and enacted its current retaliatory statute in 1959 (Cal. Stats. 1959, ch. 2120, § 1, pp. 4945-46).

McCarran-Ferguson Act, it is not necessary here to discuss or decide whether the California insurance retaliatory tax would constitute a discriminatory tax under the commerce clause standards which would apply in the absence of the McCarran-Ferguson Act. Thus Western and Southern's reliance upon authorities (such as *Boston Stock Exchange v. State Tax Commission* (1977) 429 U.S. 318) involving the commerce clause as it exists outside the McCarran-Ferguson Act when Congress' power is still dormant (see W. & S. 12-13, 29-31) is reliance which is totally misplaced. The Prudential Insurance Company tried the same tactic in 1946, and this Court succinctly stated that such authorities were "not in point." 328 U.S. at 421.

*Prudential Ins. Co. v. Benjamin* was correctly decided in 1946, and nothing has occurred in the interim to diminish its standing as solid precedent.[11] Other courts have accepted its holdings without question.[12] In a case decided on June 9, 1980, this Court has just cited the *Benjamin* decision as illustrative of Congress' power to exempt the states from commerce clause restraints. *Lewis v. BT Investment Managers, Inc.* (1980) ..... U.S. ....., 48 U.S.L.W. 4638, 4643.[13] In 1979 this Court, after an independent survey of the

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11. The *Benjamin* holding that the exemption from commerce clause restraints provided by the McCarran-Ferguson Act extends to all taxation and regulation of interstate insurance business has not been questioned; it might be noted, however, that federal regulation of the insurance companies' relationships with their stockholders, not being part of the insurance business, are not affected by the McCarran-Ferguson Act. *SEC v. National Securities, Inc.* (1969) 393 U.S. 453, 458-61.

12. *See, e.g., Franklin Life Ins. Co. v. State Board of Equalization* (1965) 63 Cal.2d 222, 225 n. 2; 404 P.2d 477, 480 n. 2; *Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 11-12, 62 Cal. Rptr. 784, 791.

13. The *amicus curiae* brief of the Solicitor General relies upon *Lewis* (U.S. 12) while ignoring that decision's recognition of Congress' broad power to exempt whole areas of the law from commerce clause coverage.

legislative history of the McCarran-Ferguson Act, echoed the holding of *Prudential v. Benjamin* in stating that the "primary concern" of Congress in the McCarran-Ferguson Act "was in enacting legislation that would ensure that the States would continue to have the ability to tax and regulate the business of insurance. . . . In short, the McCarran-Ferguson Act freed the States to continue to regulate and tax the business of insurance companies, in spite of the Commerce Clause." *Group Life & Health Ins. Co. v. Royal Drug Co.* (1979) 440 U.S. 205, 217-18 & n. 18, 219.[14] Finally, for more than thirty-four years Congress has indicated agreement with the landmark decision of *Prudential Ins. Co. v. Benjamin* by not passing any legislation that would have any adverse effect on the *Benjamin* case's interpretation of the McCarran-Ferguson Act. *See Canada Packers v. A., T. & S. F. R. Co.* (1966) 385 U.S. 182, 183-84.

Given this history, one must admire Western and Southern's courage in suggesting that, if appellant's strained and erroneous interpretation of the *Prudential Ins Co. v. Benjamin* decision is not accepted, then this Court now should abandon its prior decision.

**3. THIS COURT APPLIED PRUDENTIAL INS. CO. V. BENJAMIN IN PRUDENTIAL INS. CO. V. HOBBS TO UPHOLD A KANSAS COMPARATIVE RETALIATORY TAX WHICH THE CALIFORNIA COURTS HAVE CORRECTLY RECOGNIZED AS BEING "SUBSTANTIALLY IDENTICAL" TO THE CALIFORNIA COMPARATIVE TAX CHALLENGED HEREIN.**

As noted above, the *Prudential Ins. Co. v. Benjamin* decision established that even when a state tax on an out-of-

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14. The Solicitor General now argues (U.S. 15-16) that the congressional debate regarding the McCarran-Ferguson Act principally concerned antitrust legislation, with state taxation meriting only occasional brief references. In *Group Life & Health Ins. Co.* this Court held that the *secondary* purpose of the McCarran-Ferguson Act, after its primary purpose of allowing state regulation and taxation of the business of insurance companies free of *all* commerce clause restraint, was "to give insurance companies only a limited exemption from antitrust laws" *Id.*

state insurance company would be discriminatory so as to violate the commerce clause in absence of congressional action, the McCarran-Ferguson Act permits such a tax to be imposed without any commerce clause restraint. Thus even if, as claimed by Western and Southern and the Solicitor General, it is assumed that the comparative retaliatory insurance tax is anticompetitive and discriminatory against interstate commerce, this Court would need to do nothing more than to affirm its validity under the commerce clause with a *per curiam* opinion citing *Prudential Ins. Co. v. Benjamin.* In fact, this Court has already done just that, in *Prudential Ins. Co. v. Hobbs* (1946) 328 U.S. 822 (*per curiam*).

The comparative retaliatory tax which was in issue in *Prudential Ins. Co. v. Hobbs* has previously been recognized as being "substantially identical to [California] Insurance Code section 685" (*Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 10, 62 Cal. Rptr. 784, 790), which is the precise statutory provision which has been applied (under the consistent California constitutional provision as amended in 1964) in the present case.

*Hobbs* involved several Kansas insurance taxes; one of the taxes involved was the Kansas retaliatory tax which was a purely "comparative" tax in that it required as a condition for its application that the foreign state impose a higher basic tax burden on Kansas insurers than Kansas imposed on that state's insurers, but it did not require that the other state have any internal domestic/foreign discrimination within its own laws to trigger the application of the Kansas retaliatory tax.[15]

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15. ". . . G.S. 1935, 40-253 provides that when the laws of a state under which the insurance company was incorporated require the payment of greater taxes, etc. from insurance companies of

Thus *Hobbs* did involve a state retaliatory insurance tax provision "substantially identical" to the California retaliatory tax as it exists at the present time and which the California Court of Appeal, citing *Hobbs* (J.A. 84, 89), has found to be constitutional. The Kansas Supreme Court in *Hobbs* found this retaliatory tax (and the other Kansas insurance taxes) to not be in violation of the commerce clause of the United States Constitution. *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 P.2d 726, 733, 735. This United States Supreme Court affirmed that holding in a *per curiam* decision, citing *Prudential Ins. Co. v. Benjamin* (1946) 328 U.S. 408.

By citing the *Benjamin* case in support of its affirmance of the constitutionality of the Kansas tax statutes in its *per curiam Hobbs* decision, this Court clearly held that each of those statutes were valid under the McCarran-Ferguson Act; if it did not (as Western and Southern argues), what was this Court's ruling as to the retaliatory tax in *Hobbs?* The Solicitor General (U.S. 17-18) joins Western and Southern (W. & S. 11-12, 26) in arguing that *Hobbs* cannot stand for more than *Benjamin,* thus contending by implication that this Court in affirming the Kansas decision somehow failed to pass upon the validity of the comparative retaliatory tax that was an integral part of the case before it. In other words, Western and Southern and the Solicitor

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other states than is required by the existing laws of this state, then such companies shall pay the taxes, etc. which would be required by a company organized in this state in order to do business in such other state." *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 P.2d 726, 730, *aff'd per curiam sub nom. Prudential Ins. Co. v. Hobbs* (1946) 328 U.S. 822.

Given the nature of the retaliatory tax it is submitted that the statement quoted at the top of page 19 of LICONY's brief (and referred to at W. & S. 26-27) apparently was referring to one of the other Kansas taxes involved in *Hobbs.*

General argue that in 1946, one week after its *Benjamin* decision, this Court did not realize what it was doing when it made its *Hobbs* ruling.[16] Appellee State Board of Equalization believes it is clear that in *Hobbs* this Court meant to do just what it did: to apply the principles of the *Benjamin* case involving the McCarran-Ferguson Act in upholding the validity of a comparative retaliatory tax against an attack made in the name of the commerce clause.

Given the clarity of the McCarran-Ferguson Act and of this Court's decision in *Prudential Ins. Co. v. Benjamin,* and given the application of that decision in affirming (in *Prudential Ins. Co. v. Hobbs*) the validity of the Kansas retaliatory tax which was substantially identical to the California retaliatory tax now at issue, there can be no real question: the California Court of Appeal was correct in holding that the California comparative insurance retaliatory tax is valid when considered with reference to the commerce clause.

### B. The Classification of Insurers Under the California Retaliatory Tax Rests on a Reasonable Basis and Is Consistent with Due Process and Equal Protection Guaranties.

#### 1. INTRODUCTION

Both Western and Southern (W. & S. 14) and the trial court (J.A. 66) mention due process rights but fail to support their claims that Western and Southern's rights to due process of law have somehow been violated. Therefore, in this brief we shall assume that whatever due process

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16. Other *amici curiae* supporting Western and Southern tend to bypass the commerce clause issue. The State of New York never really deals with it, and LICONY merely adopts the Solicitor General's arguments (LICONY 4, 16). This lukewarm approach is understandable: in Hellerstein & Hellerstein, *State and Local Taxation* (4th ed. 1978) the author of the LICONY brief acknowledges that the McCarran-Ferguson Act "set aside *any* Commerce Clause barrier to State regulation of insurance" and that *Prudential Ins. Co. v. Benjamin* "upheld the constitutionality of the above Act as applied to taxes." *Id.* at 338 (emphasis added).

question which might exist would be concurrently resolved with the equal protection question of whether the distinctions or classifications inherent in the California insurance retaliatory tax have a rational basis.[17]

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17. As noted below (p. 45) the California gross premiums tax is a privilege tax, and as held by the California Court of Appeal (J.A. 87), the California retaliatory tax and the gross premiums tax "are but parts of a single taxation scheme." The LICONY *amicus* brief refers to the retaliatory tax itself as a privilege tax. LICONY 9. When the retaliatory tax is viewed as a privilege tax, there is no need to analyze further the Legislature's rational basis for the tax. *Phila. Fire Association v. New York* (1886) 119 U.S. 110, wherein this Court upheld the constitutionality of an insurance retaliatory tax against an equal protection claim, apparently was based on the now-obsolete theory (see above pp. 8-10) that a state could impose *any* conditions upon a corporation seeking entry, that only after entry would the corporation be a "person" entitled to the equal protection of the state's laws. Given the obsolete nature of the theory supporting the holding in *Phila. Fire Association*, no reliance now is placed by California on that case. However, in the more modern cases which recognize that all corporations are entitled to equal protection of the law, this Court has made it clear that, absent the special facts of *Southern Railway Co. v. Greene* (1910) 216 U.S. 400 (corporation with immense investments in property irretrievably devoted to a limited and monopolistic use), a state may constitutionally impose new *privilege* tax burdens on foreign corporations already doing business in the state without imposing equivalent burdens on domestic corporations. *Cheney Brothers Co. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Baltic Mining Co. v. Massachusetts* (1913) 231 U.S. 68, 87-88; *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494, 510-12, 514-15; *Lincoln Life Ins. Co. v. Read* (1945) 325 U.S. 673, 674, 675-78. Thus when the retaliatory tax is treated as a pure privilege tax, there is no need to go any further in determining a reasonable basis for the classification, for the *Southern Railway* case is distinguishable on its facts, and such cases as *WHYY v. Glassboro* (1968) 393 U.S. 117 (*per curiam*), *Reserve Life Insurance Co. v. Bowers* (1965) 380 U.S. 258 (*per curiam*) and *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562, can be distinguished on the basis that they involved ad valorem property taxes. In any event, it is not necessary to rest wholly on the basis that the retaliatory tax is part of the California privilege tax on insurers. As will now be shown, the California Legislature had other clear and reasonable bases for making the retaliatory tax classifications.

**2. THERE IS A PRESUMPTION, EXCEPTIONALLY STRONG UNDER THE SPECIAL FACTS OF THIS CASE, THAT CALIFORNIA'S INSURANCE TAX LAW IS CONSISTENT WITH THE CONSTITUTIONAL REQUIREMENT THAT THE LEGISLATURE HAD A LEGITIMATE PURPOSE AND A RATIONAL BASIS FOR THE CLASSIFICATIONS CONTAINED THEREIN.**

It is a long standing rule that " 'in taxation, even more than in other fields, legislatures possess the greatest freedom in classification.' " *Lehnhausen v. Lake Shore Auto Parts Co.* (1973) 410 U.S. 356, 364. There is a presumption of constitutionality which gives rise to a burden on the one attacking the legislative arrangement " 'to negative every conceivable basis which might support it.' " *Id.* The wide breadth and outside limit of the state's taxing power with relation to the equal protection clause was summarized as follows in *Allied Stores of Ohio v. Bowers* (1959) 358 U.S. 522, 526-27:

> "The States have a very wide discretion in the laying of their taxes. When dealing with their proper domestic concerns, and not trenching upon the prerogatives of the National Government or violating the guaranties of the Federal Constitution, the States have the attribute of sovereign powers in devising their fiscal systems to insure revenue and foster their local interests. Of course, the States, in the exercise of their taxing power, are subject to the requirements of the Equal Protection Clause of the Fourteenth Amendment. But that clause imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation. The State may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products. It is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value. [Citations.] 'To hold otherwise would be to subject the essential taxing power of the State to an intolerable supervision, hostile to the basic principles of our Government and wholly beyond the protection which the general clause of the Fourteenth Amendment was intended to assure.' [Citation.]

> "But there is a point beyond which the State cannot go without violating the Equal Protection Clause. The State must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary. The rule often has been stated to be that the classification 'must rest upon some ground of difference having a fair and substantial relation to the object of the legislation.' [Citations.]"

In applying these standards in this case, due recognition should be given to the special status of state taxation of insurance corporations. First, being a corporation, Western and Southern is not a "citizen" who is entitled to rights under the privileges and immunities clause of the United States Constitution. *Asbury Hospital v. Cass County* (1945) 326 U.S. 207, 210-11; *Paul v. Virginia* (1869) 8 Wall. 168, 177. Second, as shown above, this case involves the business of insurance, a type of interstate commerce which Congress by the McCarran-Ferguson Act has left completely in the hands of the states insofar as removing all commerce clause restraint from the states as to its regulation and taxation. Thus this case presents a very purified equal protection issue which is outside of any influence of the interstate protections provided by the commerce clause or the privileges and immunities clause;[18] affirmance of the validity of the retaliatory tax as to Western and Southern does not mean that such a tax could be applied to individuals and corporations that are entitled to the protections of the commerce or privileges and immunities clauses.

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18. Therefore all reliance upon privileges and immunities cases (such as *Austin v. New Hampshire* (1975) 420 U.S. 656 (cited W. & S. 32, LICONY 14, N.Y. 5-6) and portions of *Toomer v. Witsell* (1948) 334 U.S. 385 (cited U.S. 10)) is misplaced, as is the Solicitor General's reliance (U.S. 10) on the commerce clause portions of *Toomer v. Witsell, id.*, and on *A&P Tea Co. v. Cottrell* (1976) 424 U.S. 366, another commerce clause case wherein this Court explicitly declined to consider an equal protection claim.

The McCarran-Ferguson Act has a further effect as to the application in this case of the equal protection clause of the Fourteenth Amendment. Although this Court has recognized that Congress was not empowered and did not intend to dispense with non-commerce clause constitutional rights of insurance companies (*Prudential Ins. Co.* v. *Benjamin,* 328 U.S. 408, 430), in interpreting the Fourteenth Amendment this Court has given great weight to the policy formulated by Congress in the McCarran-Ferguson Act as to insurance companies. *See State Bd. of Ins. v. Todd Shipyards* (1962) 370 U.S. 451.[19] As noted above, this Court in *Prudential v. Benjamin,* 328 U.S. 408, 437-38, held that the South Carolina privilege tax (which was only imposed on foreign insurers) did not deny equal protection. In *Benjamin* this Court also clearly indicated that, given Congress' action in exerting its power to exempt the states from all *commerce clause* restrictions as to regulation and taxation of insurance business, a markedly heavier burden applies to any insurance company which challenges state regulation or taxation under any *other* constitutional provision or provisions:

> "Clear and gross must be the evil which would nullify such an exertion, one which would arise only by exceeding beyond cavil some explicit and compelling limitation imposed by a constitutional provision or provisions designed and intended to outlaw the action taken entirely from our constitutional framework." *Id.* at 436.

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19. Contrary to LICONY's argument (LICONY 18), the Board does not agree (and has not stated) that the McCarran-Ferguson Act had absolutely no effect on the Fourteenth Amendment guaranties. *Todd Shipyards,* wherein this Court decided that several post-McCarran-Ferguson Act due process decisions would not be applicable to insurance companies, reveals the extent to which this Court has gone in giving effect to congressional policies espoused in the McCarran-Ferguson Act.

### 3. GIVEN THE SPECIAL CONTEXT OF THIS CASE, IT IS PARTICULARLY CLEAR THAT THE OBJECT AND THE CLASSIFICATION OF THE CALIFORNIA RETALIATORY TAX FULLY COMPLY WITH EQUAL PROTECTION REQUIREMENTS.

Not only do Western and Southern and its supporters fail to acknowledge the higher burden they face in the special context of this case; they do not even accept the challenge offered them by the general equal protection standards set forth so clearly in this Court's opinion in *Allied Stores v. Bowers,* quoted above. Instead they seek solace in the proposed standard which this Court declined to adopt in *Allied Stores,* and which accordingly appears in the *Allied Stores* concurring opinion. Said concurring opinion, which specifically drew a distinction between equal protection tax cases generally on the one hand and "ad valorem property tax" cases on the other, 358 U.S. at 532-33, proposed that in such ad valorem property tax cases the equal protection clause should be construed as having a significant bias *against* state distinctions which bear more heavily on out-of-state businesses. *Id.*

Western and Southern and its supporters would take this proposed standard outside of its own designated ad valorem property tax context and apply it to the retaliatory tax. In apparent recognition that a bias *in favor* of certain classes of business (those from out-of-state) has no place in a constitutional provision which guarantees *equal* protection, this Court has not adopted any such bias in its equal protection decisions. While it is clear that differences in residency *per se* do not normally provide a rational basis for classification,[20] it is also clear that the mere fact that

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20. *See, e.g., Herndon v. Chi., Rock Island & Pac. Ry.* (1910) 218 U.S. 135, 158-59; *Power Co. v. Saunders* (1927) 274 U.S. 490, 493-94; *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562, 572 (discussed in detail below at pp. 39-41); *Reserve Life Ins. Co. v. Bowers* (1965) 380 U.S. 258 (*per curiam*); *WHYY v. Glassboro* (1968) 393 U.S. 117, 120 (*per curiam*), all relied upon by Western and Southern. Although *Southern Railway Co. v. Greene* (1910) 216 U.S. 400 (also relied upon by Western and Southern) has been

heavier burdens are placed on nonresidents as compared to residents does not determine that there is an equal protection violation. In addition to privilege tax situations (see above p. 21 n. 17), this Court has long upheld heavier burdens on nonresidents as long as more than mere nonresidency is present to justify the classification, even though the justification may arise because of the difference in residences. *See, e.g., Baldwin v. Montana Fish and Game Comm'n* (1978) 436 U.S. 371, 388-90 (substantially higher hunting license fees on nonresidents); *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, 810-14 (substantially heavier burdens of documentation on out-of-state scrap processors); *Metropolitan Co. v. Brownell* (1935) 294 U.S. 580, 582-86 (imposition only upon foreign businesses of a three-year minimum on contractual limitations for insureds' suits against the insurers). In each of these cases this Court has proceeded on the basis that a state's application of heavier burdens upon nonresident corporations or individuals does not deny equal protection as long as the classification has a basis which is rationally related to a proper purpose of the statute.[21] This is exactly the same standard which was applied by this Court in *Allied Stores* in upholding a state statute which placed greater burdens on *domestic* businesses: "That a statute may discriminate in favor of a certain class does not render it arbitrary if the discrimination is founded upon a reasonable distinction, or difference in state policy." *Allied Stores v. Bowers,* 358 U.S. at 528 (see further quotation above at pp. 22-23).

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limited to its facts with regard to any continuing effect as a privilege tax case (see below p. 47), it is also distinguishable from the current issue on the basis that the classification in *Southern Railway* rested solely on the basis of different residences.

21. This line of United States Supreme Court cases is directly contrary to the language of the District Court in *Western Union Telegraph Co. v. Frear* (W.D. Wis. 1914) 216 Fed. 199, which is heavily relied upon by Western and Southern (W. & S. 9, 18).

When applying the equal protection standards set by this Court in the above cases, the case at bar is quite simple. One of the California Legislature's bases for enacting the California insurance retaliatory tax was to benefit its domestic insurers by encouraging foreign states to provide treatment for those California insurers which was as favorable as the tax burdens California was imposing on foreign insurers.[22] Fostering the domestic California insurance industry by encouraging evenhanded tax treatment of California insurers certainly is a proper interest of the State of California; the only remaining equal protection test is whether the classification made has a reasonable relation to the object of the legislation. Contrary to the claims of Western and Southern (W. & S. 21) and the Solicitor General (U.S. 10), the classification challenged here was not made solely on the basis that Western and Southern was from a state other than California. The California comparative retaliatory tax does not classify all out-of-state insurers together and impose greater burdens upon such insurers as a group; rather, the statute separately classifies each insurer by the way that insurer's home state would treat a similar insurer from the state having the retaliatory statute.[23] It is only when the insurer's home state would impose a greater aggregate burden on a California insurer with the same characteristics that California will subject the foreign insurer to the California

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22. See *Western & Southern Life Ins. Co. v. State Bd. of Equalization* (1970) 4 Cal.App.3d 21, 34.

23. In upholding the equal protection validity of the pre-1964 California retaliatory tax, *Franklin Life Ins. Co v. State Board of Equalization* (1965) 63 Cal.2d 222, 232-33, 404 P.2d 477, 485, demonstrated that such a comparative test does not even classify all insurers from the same state together; given the aggregate nature of the test in satisfying the intent behind the statutes, some insurers from one state may be subject to the tax while others from the same state with different characteristics are not.

retaliatory tax. Thus the class subject to the tax is exactly limited to those insurers whose home states are susceptible to pressure to lower their burdens to the California level.[24]

The California retaliatory tax fully satisfies the equal protection standard as stated and applied by this Court through the years and as quoted above at pp. 22-23. Its conformance to that standard is particularly clear when the case is viewed in the special context of state taxation of insurance corporations after the enactment of the McCarran-Ferguson Act; in that context a statute regulating or taxing interstate insurance business must be a "clear and gross evil exceeding beyond cavil" some "explicit and compelling" constitutional limitation before it can possibly constitute a violation of a constitutional provision such as the equal protection clause. See above, p. 24.

#### 4. THERE WAS AND IS A RATIONAL BASIS FOR THE CALIFORNIA RETALIATORY TAX WHICH FULLY REFLECTS ANY AND ALL ELEMENTS OF FEDERALISM WITHIN THE EQUAL PROTECTION CLAUSE.

The California comparative retaliatory tax is still valid if the equal protection clause in the context of this case has the extra element of federalism suggested in the concurring opinion in *Allied Stores*. The first object of the California tax mentioned above is not to extract extra revenues from foreign insurance companies[25] but to achieve tax bur-

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24. Western and Southern argues (W. & S. 17-20) that to be valid the classification must be based on differences between the entities being classified *other than* differences having to do with different home states. This is not so; for example, in *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, a discrimination against out-of-state scrap processors whose manners of operations were assumed to be identical to domestic processors was held to be a reasonable classification under equal protection standards. *Id.* at 811. As indicated above at pp. 25-26, support for valid classifications may arise *because* of the different residences, even though different residences *per se* could not alone satisfy the rational basis test under the equal protection clause.

25. Any increase in revenue to California due to the retaliatory tax is incidental. *See Western & Southern Life Ins. Co. v. State Bd. of Equalization* (1970) 4 Cal.App.3d 21, 34, 84 Cal. Rptr. 88, 96, and Ohio and Washington cases cited therein.

dens in other states for California insurers which are equal to or less than California's general (nonretaliatory) burden on all insurers; if that objective were completely achieved the retaliatory tax would no longer be collected at all due to equalization of the basic tax burdens. But the objective behind the retaliatory tax is broader than that: As pointed out by the California Court of Appeal (J.A. 82-83), the more general purpose of retaliatory taxes is "to put pressure on the several states to impose the same tax burden on all insurance companies" and thereby "encourage the doing of interstate business." As phrased in *Atlantic Insurance Co. v. State Board of Equalization* (1967) 255 Cal. App.2d at 15, 62 Cal. Rptr. at 793, citing *Bankers Life Co. v. Richardson* (1923) 192 Cal. 113, 124, 218 Pac. 586, 591, retaliatory insurance tax laws are enacted to "secure reciprocity" and "to achieve uniformity of treatment and not to discriminate." In fact, such laws are intended to discourage any state from imposing discriminatory burdens upon out-of-state insurance companies. *Id.* at 4; 62 Cal. Rptr. at 786.[26]

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26. The following examples demonstrate how these objectives are achieved by a comparative retaliatory tax. Assume that state A levies a relatively heavy tax burden on all insurers. If states B, C, and D have lower insurance tax burdens and no comparative retaliatory taxes, the economies of states B, C, and D, through payment of high state A taxes by their domiciliary insurers, will be generating disproportionate tax revenue support to state A, while state A's insurers enjoy the lesser burdens in states B, C, and D. If states B, C, and D enact comparative retaliatory taxes, state A's insurers will find themselves paying high burdens everywhere; they will thus bring great pressure on state A to adjust its insurance tax burdens down to the lower levels of states B, C, and D. Once those levels are matched, no further retaliatory taxes will be collected although the retaliatory tax statutes remain on the statute books.

The purely comparative retaliatory statutes of states B, C, and D would have the same equalizing tendencies had state A originally discriminated within its own tax laws so as to impose a lesser burden on its domestic insurers than it imposed on insurers from states B, C, and D. Assume that state A imposed the same burden upon its own domestic insurers as states B, C, and D imposed upon

Other states have upheld the validity of their comparative insurance retaliatory tax laws and have recognized the common purposes of equalizing tax burdens and preventing discrimination. In *Phoenix Ins. Co. v. Welch* (1883) 29 Kan. 672, 32 Pac. States Rep. 480, the Kansas Supreme Court found the Kansas comparative retaliatory provision to be more "a provision of reciprocity":

> "It is, in brief, an appeal for comity; a demand for equality. As such, it is manifestly fair and just. It arouses no sense of injustice, and simply says to every other state in the Union: 'We will meet you on the basis of equality and comity, and will treat you as you treat us.'" *Id.* at 675, 32 Pac. States Rep. at 482.[27]

The Kansas Supreme Court then held the retaliatory provision to be consistent with the Kansas Constitution's principle of equality of taxation; the Kansas holding would be equally appropriate here:

> "The legislature may classify for the purposes of taxation or license, and when the classification is in its nature not arbitrary, but just and fair, there can be no constitutional objection to it.... Here foreign insurance corporations are classified by the states from which they come, and, when we consider the purposes of such classification, it cannot be held that there is anything arbitrary or unjust therein." *Id.* at 678, 32 Pac. States Rep. at 484-85.

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all insurers, but that state A imposed a discriminatory higher burden upon all insurers from outside state A. Under the comparative retaliatory taxes states B, C, and D would increase their burden so as to impose the same tax burden on state A's insurers as the higher burden which state A imposed on insurers from states B, C, and D. The resulting pressure on state A would be to end its internal discrimination and lower its taxes on out-of-state insurers to match the normal (non-retaliatory) burdens imposed upon all insurers by states B, C, and D.

27. *See also, Indemnity Ins. Co. of North America v. Stowell* (1961) 172 Ohio St. 167, 174 N.E.2d 536; 539; *In re Insurance Tax Cases* (1945) 160 Kan. 300, 161 P.2d 726, 730, *aff'd sub nom. Prudential Insurance Co. v. Hobbs* (1946) 328 U.S. 822; *Pacific*

*Accord: Baldwin v. Insurance Co. North America* (1888) 115 Ind. 257, 17 N.E. 574, 579. The validity of the Pennsylvania comparative retaliatory tax was upheld in *Commonwealth v. Fireman's Fund Ins. Co.* (1952) 369 Pa. 560, 87 A. 2d 255, wherein the Pennsylvania Supreme Court also declared that the purpose of the retaliatory tax is not to raise revenue but "to bring about equality of treatment between domestic and foreign corporations and to break down interstate barriers." *Id.* at 258.

This broader purpose behind retaliatory insurance tax statutes is particularly appropriate in the post-McCarran-Ferguson Act context, where the states can tax the interstate commerce of insurance without any of the normal restraints of the commerce clause. The retaliatory statutes of the states themselves serve as a partial substitute for the commerce clause, encouraging states to recognize the advantages of common trade between the several states by maintaining relative uniformity of state insurance tax burdens. Due to the fact that the insurance tax system is composed of the statutes of the individual states, the retaliatory tax also fosters the interstate commerce of insurance by tending to keep insurance tax rates from increasing at the same pace as other state taxes, even in these times when the states are experiencing increasing revenue pressures. Any one state which raised its tax burden above the other states' burdens would be jeopardizing its own insurance industry by causing it to be subject to retaliatory taxes in the other states. Thus, using the words of the *Allied Stores* concurring opinion, the objectives and

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*Mut. Life Ins. Co. v. State* (1931) 161 Wash. 135, 296 Pac. 813, 814-15. Some states (Alabama, Idaho, Kentucky, Wyoming) include in their comparative retaliatory statutes statements designating the purpose of the statute as being protection against "discriminatory or onerous requirements" under the laws of other states. Citations to the retaliatory insurance statutes of the various states are included in Appendix B attached hereto.

structure of the retaliatory tax serve to "adjust[ ] the demands of individual States to . . . tax these enterprises in light of the multistate nature of our federation." 358 U.S. at 532. The overall thrust of the retaliatory tax is fully reflective of any element of federalism which is contained in the equal protection clause.

### 5. THE LOGICAL LEGISLATIVE ASSUMPTIONS SUPPORTING THE CALIFORNIA RETALIATORY TAX ARE SUPPORTED, NOT REFUTED, BY THE FACTS.

This Court has very recently restated the following rule:

> "In an equal protection case of this type . . . those challenging the legislative judgment must convince the court that the legislative facts on which the classification is apparently based could not reasonably be conceived to be true by the governmental decisionmaker. [Citations.]" *Vance v. Bradley* (1979) 440 U.S. 93, 111.

In the *Vance* case this Court rejected a challenge to a mandatory retirement age of 60 for foreign service employees. The challengers had presented empirical evidence against such a requirement and argued that the government was required to offer "current empirical proof" to support the legislative classification. In reply, this Court quoted *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, 812, in stating that " '[t]he State is not compelled to verify logical assumptions with statistical evidence.' " 440 U.S. at 110 n. 28. The *Vance* decision concludes that if the facts are even "arguable" the legislative classification will be immunized from constitutional attack. *Id.* at 112.

The amicus brief of LICONY attempts and fails to surmount this extremely high burden of proof. The truth is that a look at the real world tends to corroborate the logical assumptions (set forth above) as to the operation of the retaliatory tax on insurers.

One quite important fact is the near universality of insurance retaliatory statutes among the states. Forty-nine of the fifty states have comparative retaliatory statutes in their statute books, and apparently 48 of those 49 comparative retaliatory taxes are collected whenever their terms permit.[28] So far as is known, even New York, whose attorney general is challenging the constitutional validity of the California retaliatory statute as *amicus curiae* for Western and Southern herein, is still more than happy to collect any retaliatory taxes which might become due under the New York comparative retaliatory statute. N.Y. Ins. Law § 61. Thus 96% of the states apparently are collecting comparative retaliatory insurance taxes whenever their statutory conditions are satisfied. This near universality of the retaliatory statute gives considerable force to the legislative assumptions behind the California retaliatory tax. A state which wishes to increase its insurance tax burdens to a high level has to worry about more than just California's law; it must consider the nation-wide impact upon its own insurance industry that any such increase might have.[29]

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28. A list of these statutes is appended hereto as Appendix B. Hawaii has no retaliatory tax law pertaining to insurance business. The insurance retaliatory laws of New Mexico are upon insurance brokers and insurance agents respectively and not directly upon insurance companies. Appellee is informed that North Carolina has exercised statutory discretion and does not actually collect the comparative retaliatory taxes provided for in section 58-152 of the North Carolina General Statutes; thus potential conflict with N.C. Gen. Stat. § 105-228.8 need not be resolved.

29. New York provides an example of the type of pressures experienced by a state which attempts to fight the federalistic restraints of the retaliatory tax system. As detailed in footnote 1 of the LICONY brief (LICONY 2-3) New York has attempted to break out of the retaliatory tax pattern by imposing tax burdens with a relatively high ceiling of 2.6% of taxable premiums; however, in its quest for more tax revenues, New York has experienced an exodus of domestic companies from New York (N.Y. 3) and has felt the brunt of the retaliatory tax system to such an extent

As noted above (p. 29), one of the objectives of the retaliatory taxes is to obtain uniformity of treatment; LICONY argues (LICONY 19-22) that this objective is not borne out by actual facts. However, using LICONY's own figures in its Appendix B regarding taxation of out-of-state life insurers, it can be seen that twenty-six states share the same exact tax rate of 2%, with none below 1% and only three states (Hawaii (3.197%), Oklahoma (4%), and Texas (3.3%)) above 3%. Furthermore, the differences in the inner workings of the basic insurance taxes which LICONY complains of on pages 20 and 21 of its brief are rendered irrelevant by the aggregate nature of application of California's comparative retaliatory tax. In determining under the aggregate method whether the retaliatory tax will apply, the *total burden* that would be imposed upon a similar California insurer for doing business under the foreign state's law is compared with the *total burden* for doing business imposed by California upon the foreign insurer. *See Bankers Life Co. v. Richardson* (1923) 192 Cal. 113, 122-25, 218 Pac. 586, 590-91.[30] Thus the California re-

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that it now grants a *credit* to its domestic companies for 90% of any retaliatory taxes they are required to pay to other states. N.Y. Tax Law § 1511(c). This 90% credit, whereby New York indirectly pays the retaliatory taxes of the New York insurers, gives rise to the question as to the true extent of the interest of the members of the Life Insurance Council of New York (LICONY) in this matter. In its brief LICONY fails to note that if the retaliatory tax were held to be invalid, LICONY'S members would lose the benefits of their current favored position (due to the 90% credit) under New York law, and they would be subjected to whatever further rate increases that New York is anxious to impose but has not because of the retaliatory tax system. It also can be reasonably assumed that soon after any abolishment of the retaliatory tax, the members of LICONY would find themselves paying more in increased basic premiums taxes in other states than they are now paying in retaliatory taxes.

30. Since California has adopted the aggregate method, the "item by item" method illustrated on page 21, note 8 of LICONY's brief is not at issue here. In any event, LICONY itself reports (LICONY App. C, p. 8a) that only four states have administered their statutes by utilizing the "item-by-item" method.

taliatory tax is concerned with uniformity of treatment with regard to equalizing total tax burdens as between similar insurers in the several states; it is not concerned with making every aspect of every state insurance statute identical. Certainly under the standards stated in *Vance v. Bradley, supra,* a legislature could reasonably conceive as true the proposition that, at a time when retaliatory taxes are almost universal among the states, the basic tax burdens imposed by those states tend toward uniformity.

What of the secondary thrust of the retaliatory tax; does it tend to keep the general level of insurance tax burdens from increasing? In 1964 it was reported that "the tax on premiums has stayed close to two percent in most states." Pelletier, "Insurance Retaliatory Laws," 39 Notre Dame Lawyer 243, 247. The current facts drawn from LICONY's appendix B and set forth above as to taxes on foreign life insurance companies could be summarized by exactly the same statement, even though fourteen years of great tax expansion in other areas have passed in the interim. LICONY's own quoted authority (Bodily, "The Effects of Retaliation on the State Taxation of Life Insurers," 44 J. of Risk & Insurance 21 (1977) (cited LICONY 22-23)) reports that life insurance rates "have increased little since the assumed low starting rate of 1935." *Id.* at 30. That author merely believes that retaliatory provisions have not been the cause of the low rates, although he recognizes that the contrary conclusion is "theoretically possible." *Id.* at 34, quoted LICONY 22. Such possibility is sufficient to satisfy the standards for constitutionality under *Vance v. Bradley,* where this Court held that "the very admission that the facts are arguable . . . immunizes from constitutional attack the congressional judgment represented by this statute." 440 U.S. at 112.

LICONY's other cited authorities recognize the effectiveness of the retaliatory tax system. Strickler, "The Mess in State Premium Taxation of Insurance Companies," vol. 69, nos. 9 and 10, Best's Review (Property/Liability Ins. Ed.) 34 (1969) (quoted LICONY 24-25), forthrightly states that "[t]he dominant result [of the retaliatory tax system] is a dampening effect on out-of-staters' tax bites . . ." (*id.* at 38). Similarly, the reason given by the New Jersey Tax Policy Committee (see LICONY 25) for the recommended abolishment of the retaliatory tax system (by the federal Congress, not unilaterally by New Jersey) was that the system works too *well*: "retaliatory insurance taxes virtually preclude any increase in this State's level of insurance taxes." Report of the New Jersey Tax Policy Committee, Part V, 47, 48, 50 (1972).[31]

The logical assumptions that retaliatory taxes encourage uniformity of tax burdens and retard general increases in those insurance tax burdens are also corroborated by the very presence of the broad and national representation of the insurance industry as *amici curiae in support of the California State Board of Equalization's position* in this case in defense of the retaliatory tax; the national insurance industry (including members from New York) would not be supporting this tax on insurers if the current retaliatory tax system were not to the industry's benefit; its conclusion regarding the benefit to the insurance industry of a universal system of retaliatory tax laws is supported by such authorities as Felton, "Retaliatory Insurance Company Taxation," 38 J. of Insurance 71, 80 (1961).

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31. Similar concerns may have contributed to the statement emanating from the National Association of Insurance Commissioners, which statement is quoted on page 24 of LICONY's brief. In any event, the elimination of retaliatory insurance taxes was recommended within the N.A.I.C. as only one part of "a single and indivisible program". 1 Proc. Nat'l Ass'n of Insurance Comm'rs 69, 71 (1971).

It is respectfully submitted that, under the standards set forth in *Vance v. Bradley* (1979) 440 U.S. 93, 110-12, the California Legislature had and continues to have a more than adequate basis for believing that the classification scheme set forth in the California comparative retaliatory tax statute will promote the constitutionally permissible goals of the statute.

### 6. OTHER CONTENTIONS MADE IN SUPPORT OF WESTERN AND SOUTHERN'S EQUAL PROTECTION ATTACK ON THE RETALIATORY TAX ARE WITHOUT MERIT.

#### a. Statutory reference to laws of other states is permissible.

As shown above, the application of the California retaliatory tax involves reference to the laws of the insurer's home state to compare burdens in determining what, if any, retaliatory tax is due. If retaliatory taxes are due under the California law, the out-of-state insurer presumably will pressure its home state to lower to California levels its own tax burdens on California companies.[32] If such a lowering occurs, automatic reciprocation causes the California retaliatory tax to be reduced to zero as to the foreign state's insurer. Such references to other state laws and tax reductions according to their content do not violate the Fourteenth Amendment. *See Bode v. Barrett* (1953) 344 U.S. 583, 586.

LICONY would distinguish (LICONY 10-14) the California retaliatory tax from other reciprocity statutes (such as the one involved in *Bode v. Barrett, id.*) wherein tax exemptions are provided to a nonresident if his home state grants similar exemptions to the taxing state's residents.

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32. At the least, the retaliatory tax will give the insurer a forceful argument against any *increases* in its home state's tax burdens on California insurers.

LICONY's proposed ground for distinction (LICONY 13) appears to be that if the basic tax levy is valid and no exemptions are required, then the state can impose any discriminatory method it wants regarding any credits or exemptions it chooses to provide. This approach could cause very pernicious results; it clearly is inconsistent with the reasoning behind the doctrine of unconstitutional conditions set forth above (pp. 8-10), whereby a state may exclude a corporation completely but cannot condition entry on forfeiture of constitutional rights of the corporation.

Western and Southern (W. & S. 32) and its supporters (U.S. 10, LICONY 14, N.Y. 5-6) all attempt to draw support from privileges and immunities cases such as *Austin v. New Hampshire* (1975) 420 U.S. 656 (and, in the brief of the United States, a commerce clause case, *A & P Tea Co. v. Cottrell* (1976) 424 U.S. 366), in arguing that the California tax's involvement with other states' laws and its attempt at influencing said laws somehow result in a violation of the equal protection clause. It is submitted that those cases do not apply in determining the equal protection issue presented here. The Board relies on the merits of the arguments made above in application of equal protection standards (pp. 25-31), on *Bode v. Barrett, supra,* and on the following statement from *U.S. Steel Corp. v. Multistate Tax Comm'n* (1978) 434 U.S. 452, 478:

> "Any time a State adopts a fiscal or administrative policy that affects the programs of a sister State, pressure to modify those programs may result. Unless that pressure transgresses the bounds of the Commerce Clause or the Privileges and Immunities Clause of Art. IV, § 2, *see, e.g., Austin v. New Hampshire,* 420 U.S. 656 (1975), it is not clear how our federal structure is implicated."

**b. The great contrast between the California retaliatory insurance tax and the Ohio tax in Wheeling Steel Corp. v. Glander tends to confirm the constitutionality of the California tax.**

Western and Southern relies heavily upon *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562. In reality, a close reading of *Wheeling Steel* is helpful in demonstrating why the insurance retaliatory taxes now at issue are truly reciprocal while the Ohio *ad valorem* tax involved in *Wheeling Steel* was not.

In *Wheeling Steel* Ohio attempted to impose an *ad valorem* tax on accounts receivable from sales resulting in the shipping of a commodity from an Ohio manufacturing plant, even though the seller resided outside of Ohio and the sales had occurred outside of Ohio. Ohio tried to validate this tax by providing that other states could tax Ohio residents in a similar fashion. The *Wheeling Steel* excerpts quoted by Western and Southern (W. & S. 21-22) provide the following grounds for holding that tax to be a violation of equal protection:

1. The *taxpayers* would get no benefit from the so-called reciprocity.[33] If other states accepted Ohio's offer to tax Ohio residents similarly, the Wheeling Steel Corporation would still be stuck with the entire Ohio tax, whereas in the current case if Western and Southern's home state (again Ohio) decided to reduce its insurance tax to the California level, Western and Southern would be relieved of *all* California retaliatory tax.[34]

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33. In the words of this Court, "It is hard to see that this offer of reciprocity restores to appellants [taxpayers] any of the equality which the application of the Ohio tax, considered alone, so obviously denies." 337 U.S. at 573.

34. This aspect of the retaliatory tax arises from its classification of each insurer individually on the basis of how its home state would treat a similar insurer domiciled in California (see above pp. 27-28). This classification is quite different from putting all out-of-state corporations in one class, as was attempted in cases cited on pages 17 through 19 of Western and Southern's brief.

2. In the four years between the enactment of the Ohio *ad valorem* tax and this Court's decision in *Wheeling Steel,* other states had not indicated any readiness "to copy Ohio's situs scheme". 337 U.S. at 573, 574. In contrast, in the case at bar, almost every state has a comparative insurance retaliatory tax. See above p. 33 and Appendix B.

3. The Ohio scheme was not "an even bargain between states." *Id.* at 573. In contrast to the long history and widespread enactment of state insurance retaliatory taxes, Ohio had obviously concocted a new tax scheme which would only benefit states with Ohio's special characteristics. Thus there was not much prospect for many other states to accept Ohio's offer in the future.

4. Even if other states accepted Ohio's purported "reciprocal" offer, "the equality of rates which would also be necessary to equalize the burden between non-residents and their resident competitors could be hardly expected nor is it provided for." *Id.* at 574. In *Wheeling Steel* Ohio was merely offering other states the opportunity to tax Ohio residents; as noted by the Court, there was no provision to equalize tax *rates.* In fact, the Ohio plan might well have led to an escalation of tax rates by the states upon each other's residents. In contrast, as noted in *Atlantic Ins. Co. v. State Board of Equalization* (1967) 255 Cal.App.2d 1, 4, 15 and as discussed above (pp. 34-36) the common purposes of insurance retaliatory taxes of encouraging reciprocity and avoiding discriminatory burdens have been realized by keeping insurance taxes close to 2 percent in most states.

In conclusion, *Wheeling Steel* does not conflict with the Board's discussion (above at pp. 28-37) of the truly reciprocal nature of California's retaliatory insurance tax. If anything, the *Wheeling Steel* decision provides a contrast which

only makes clearer the constitutional validity of the retaliatory tax at issue here.[35]

**c. The possibility of alternative methods does not affect the validity of the tax in issue.**

Western and Southern and its supporters present the Court with alternative types of retaliatory taxes which California might choose (see W. & S. 31, LICONY 22, N.Y. 2-3). Most would not aid the accomplishment of the purposes behind the retaliatory tax;[36] however, one suggestion (LICONY 22) is that California could carry the reciprocal element of the tax further by applying to each foreign insurer the same burden that its home state would apply to a California insurer, even when that burden was *lower* than the basic California gross premiums burden. While this procedure would be consistent with the retaliatory tax purposes, it could create other problems.[37] In any event,

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35. LICONY argues (LICONY 9-10) that the *Wheeling Steel* decision stands for the proposition that reciprocity cannot justify initial discrimination. *Wheeling Steel* stands for the opposite proposition. In *Wheeling Steel* this Court closely examined the claimed reciprocity and found that no true reciprocity existed. Presumably, since the Court felt that the reciprocity claims "require[d] scrutiny", *id.* at 572, if Ohio had provided true reciprocity it would have had a definite bearing on the constitutionality of the Ohio taxes.

36. For example, it has been shown above (pp. 29-30 n. 26) that California's current purely comparative tax combats anti-foreign insurer discrimination by other states just as effectively as the pre-1964 California tax which Western and Southern now claims "bore a semblance of justification" (W. & S. 31). New York's "reciprocal exemption" provision (N.Y. 2-3) is meant to be a step toward a defeat of the goals of the retaliatory tax system, not a step toward attainment of those goals.

37. For example, the California Legislature might balk at such a rule as being unwise because of a legislative desire to preserve the current status of the state's fiscal structure so that at least some certain minimum amount can be expected as revenues from the basic gross premiums tax. Also, the Legislature simply might desire to retain uniformity of its retaliatory statute with the form adopted by most other states.

any possibility that the California Legislature could have furthered the underlying purpose of the retaliatory tax more completely does not make the method it chose unconstitutional. *Hughes v. Alexandria Scrap Corp.* (1976) 426 U.S. 794, 813. As shown in the above discussion, the legislative purposes behind the California insurance retaliatory tax statute are proper, and the classification made by that statute is rationally related to those proper purposes. Under the equal protection standards provided by the authorities cited above at pages 22-26, the California retaliatory tax as applied to Western and Southern is valid.

## III. ONCE THE RETALIATORY TAX IS HELD TO BE CONSTITUTIONAL, THERE IS AN ADEQUATE STATE GROUND THAT RESULTS IN THERE BEING NO JURISDICTION IN THIS COURT TO DECIDE THE FEDERAL ISSUE REGARDING THE PRINCIPAL OFFICE DEDUCTION: THE CALIFORNIA COURTS HAVE DETERMINED SOLELY ON THE BASIS OF CALIFORNIA LAW THAT, GIVEN THE VALIDITY, APPLICATION AND FUNCTION OF THE RETALIATORY TAX AS ONE PART OF A CONSOLIDATED SCHEME OF CALIFORNIA INSURANCE TAXATION, IT IS UNNECESSARY TO DECIDE WESTERN AND SOUTHERN'S CHALLENGE OF THE VALIDITY OF THE GROSS PREMIUMS TAX PRINCIPAL OFFICE DEDUCTION.

Mixed in with Western and Southern's argument concerning the retaliatory tax is a challenge by Western and Southern of the constitutional validity of a 1966 amendment to the principal office deduction which used to be provided as part of the California gross premiums tax law. The entire principal office deduction (including the challenged 1966 provision) was repealed in 1976.

As the California Court of Appeal has held in the instant case (J.A. 86-87, 89), once the constitutional validity of the California retaliatory tax has been established, there is no need to determine the constitutional validity of the 1966

principal office deduction amendment on the merits, for the holding that the retaliatory tax is valid fully determines that Western and Southern is not entitled to any judgment on its suit for tax refund: any lowering of Western and Southern's California premiums tax liabilities for each year would result under California law in an identical increase in the retaliatory tax amount, so that Western and Southern's liabilities under the two taxes would still total the same as the total insurance tax liability an identical California insurer would incur in Ohio, Western and Southern's home state.[38] This outcome under the retaliatory tax results from the fact that Ohio imposed or would have imposed a greater tax burden on a similar California insurer than California imposed on Western and Southern for the years involved.

The California holding in this case, that as a matter of California law the retaliatory tax and the gross premiums tax "are but parts of a single taxation scheme" wherein no refund is due unless the taxpayer has paid more than the entire scheme required (J.A. 87, 89), is a construction of the California statutes and constitutional provisions which is binding upon this Court. *See Hebert v. Louisiana* (1926) 272 U.S. 312, 316. Furthermore, the California resolution of the principal office deduction issue on this basis constitutes an adequate state ground independent of the federal issue, not decided by the Court of Appeal, of whether the post-1966 principal office deduction to the California gross premiums tax taken by itself would have violated the constitutional rights of a foreign insurer. Given the presence of such an adequate independent state ground in the case at bar, this Court has no jurisdiction in this case over the

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38. The trial court noted the same interdependence in the minute order it issued with its memorandum of intended decision. J.A. 56.

issue of the constitutional validity of the post-1966 principal office deduction. *Herb v. Pitcairn* (1945) 324 U.S. 117, 123-24, 125-26.

## IV. IF THE RETALIATORY TAX WERE HELD TO BE UNCONSTITUTIONAL, THIS WOULD THEN BE AN APPROPRIATE CASE TO REMAND TO THE CALIFORNIA APPELLATE COURTS FOR A DETERMINATION REGARDING THE VALIDITY OF THE PRINCIPAL OFFICE DEDUCTION.

When appeal is made to this Court from a state court in a case involving a constitutional challenge to the validity of a state statute, this Court's appellate jurisdiction rests on the state court's decision being "in favor of its validity." 28 U.S.C. § 1257(2). As already noted, the validity of the now-repealed principal office deduction has not been passed upon by the California Court of Appeal or the California Supreme Court. If the retaliatory tax were held by this Court to be unconstitutional, the otherwise substantial and adequate state ground stated above at pp. 42-43 would cease to exist, for it is clearly conditioned on the continued validity of the retaliatory tax. However, there can be no question that the California Court of Appeal's ruling on the principal office deduction was made on the basis of a good faith belief in the constitutionality of the retaliatory tax.

Under these conditions this Court might well have the power to treat the California decision as if it indeed had upheld the constitutional validity of the principal office deduction, even though no such holding occurred. *Cf., Lawrence v. State Tax Comm.* (1932) 286 U.S. 276, 282-283. But such action would deprive the California Court of Appeal and the California Supreme Court of a fair chance to consider the principal office deduction issue in light of any holding of this Court of unconstitutionality regarding the retaliatory tax.

There is an additional consideration. In both the trial court and the Court of Appeal Western and Southern argued in its briefs that the principal office deduction (and the retaliatory tax) violated separate provisions of the California Constitution which Western and Southern characterized as providing "generally equivalent but independent protection" comparable to the federal Constitution.[39] Thus, there is some possibility that the California appellate courts, if faced with the issue regarding the validity of the principal office deduction, might decide that issue based on the California Constitution rather than the United States Constitution.

Under these circumstances it is respectfully submitted that, if the retaliatory tax were to be held invalid by this Court, then this would be an appropriate case to remand to the California appellate courts for determination of the validity of the principal office deduction as provided by California law until the 1976 repeal. *See Cardinale v. Louisiana* (1969) 394 U.S. 437, 438-39.

## V. THE 1966 AMENDMENT TO THE PRINCIPAL OFFICE DEDUCTION FROM THE CALIFORNIA PRIVILEGE TAX ON INSURERS WAS CONSTITUTIONALLY VALID.

The California gross premiums tax is the basic insurance tax which is imposed on all insurers in California; it is measured by gross premiums (less return premiums) received on insurance business done in California, and is clearly a *privilege* tax, not a property tax. *Carpenter v. Peoples Mut. Life Ins. Co.* (1937) 10 Cal.2d 299, 302, 74 P.2d 508, 510. Until 1976 California had provided for a deduction (the principal office deduction) from this privi-

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39. There is no question but that Western and Southern also argued the federal constitutional grounds it continues to present in its brief in this Court.

lege tax for certain real estate taxes paid regarding the insurer's California real property wherein its principal office in California was located. Western and Southern challenges the validity of a 1966 amendment whereby Western and Southern, because of the proportion (ranging from 76% to about 78%) of its California office building which was occupied by tenants other than Western and Southern, was allowed less of a deduction that it would have been allowed had it been a California insurance company with the same characteristics. See App. A, pp. 5-7. The entire principal office deduction was repealed for all insurers in 1976.

All of the principles that sustain the validity of the 1966 amendment to the privilege tax deduction have been stated earlier in this brief. Citations to those portions of this brief will avoid unnecessary repetition. It makes no difference that the 1966 amendment occurred after Western and Southern had received a California license for an indefinite term (which license was expressly conditioned upon conformance with present and future California laws). See above pp. 8-10. Due to the McCarran-Ferguson Act there can be no violation here of the commerce clause. See above pp. 11-17. Finally and most significantly, when dealing (as here) with a *privilege* tax in a situation without the special facts of *Southern Railway Co. v. Greene* (1910) 216 U.S. 400 (see next paragraph), this Court has firmly established that a state does not violate equal protection rights of foreign corporations already doing business in the state by imposing new *privilege* tax burdens on them without also imposing equivalent burdens on domestic corporations. See above p. 21 n. 17, citing *Cheney Brothers Co. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Baltic Mining Co. v. Massachusetts* (1913) 231 U.S. 68, 87-88; *Hanover Ins. Co. v.*

*Harding* (1926) 272 U.S. 494, 510-12, 514-15; *Lincoln Life Ins. Co. v. Read* (1945) 325 U.S. 673, 674, 675-78.[40]

Some further comments as to the privilege tax point are in order here. Western and Southern relies heavily on *Southern Railway Co. v. Greene* (1910) 216 U.S. 400; that case is not applicable here. First, that case's approach has been rejected by later cases which establish the doctrine of unconstitutional conditions. See above pp. 8-10. Second, even though *Southern Railway* did involve a privilege tax, later cases have strictly limited the holding in that case to its specific facts (immense investments in property only suitable for the taxpayer's particular use), facts which are distinguishable from a general use office building such as Western and Southern's. *Baltic Mining Co. v Massachusetts* (1913) 231 U.S. 68, 87-88; *Cheney Bros. Co. v. Massachusetts* (1918) 246 U.S. 147, 156-57; *Northwestern Life Ins. Co. v. Wisconsin* (1918) 247 U.S. 132, 140. Thus Southern *Railway Co. v. Greene* clearly does not apply in this case. It is just as clear that the ad valorem *property* tax cases relied upon by Western and Southern (such as *WHYY*

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40. *Hanover and Lincoln Life* both involved states which provided for the issuance of annual licenses. 272 U.S. at 503, 508, 509; 325 U.S. at 675. In *Lincoln Life* great stress was made (*id.* at 676) of the fact that the Kansas license to do business was (like California's in the present case) expressly conditioned on compliance with subsequently enacted laws. The *Lincoln Life* decision distinguished such licenses from "unequivocal" licenses, and cited *Hanover* as an "unequivocal" license case (*id.*); thus by mistakenly treating annual renewals as the determinative factor as to whether licenses were "unequivocal", the California Court in the portion of the *Atlantic* decision quoted at LICONY 7-8 n. 3 misconstrued *Lincoln Life* while correctly holding that the pre-1964 California retaliatory tax did not violate equal protection rights. In addition to the above cases involving higher privilege taxes on *foreign* corporations, in *Northwestern Life Ins. Co. v. Wisconsin* (1918) 247 U.S. 132 this Court held to be valid a privilege tax where higher burdens were placed on *domestic* insurers. Unrelated portions of the *Baltic Mining Co.* decision were disapproved in *Alpha Cement Co. v. Massachusetts*, 268 U.S. 203, 218 (1925). Similarly, the portions of *Cheney Bros.* relied upon above were unaffected by *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274 (see LICONY 15 n. 5).

*v. Glassboro* (1968) 393 U.S. 117 (*per curiam*); *Reserve Life Insurance Co. v. Bowers* (1965) 380 U.S. 258 (*per curiam*) and *Wheeling Steel Corp. v. Glander* (1949) 337 U.S. 562) have no application in this privilege tax context.[41]

## CONCLUSION

The shadow of Western and Southern's commerce clause argument fades to nothingness in the clear light of the McCarran-Ferguson Act as powerfully focused by this Court's decisions. As to equal protection rights, Western and Southern's attack on the privilege tax principal office deduction is repelled by the accumulated strength of this Court's line of decisions upholding state *privilege* tax burdens even when they are placed more heavily upon out-of-state corporations after their admission to do business. Although there have been no recent decisions of this Court which specifically uphold an insurance retaliatory tax against an attack based on equal protection claims, the equal protection standards forged and applied by this Court in other cases apply here to establish the constitutional validity of the California retaliatory insurance tax, whether or not it is treated as a privilege tax.

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41. Both sides in the current case rely upon *Hanover Ins. Co. v. Harding* (1926) 272 U.S. 494. It is true that this Court in *Hanover* found one Illinois tax (which Illinois in *Hanover Fire Ins. Co. v. Harding* (1927) 327 Ill. 590, 158 N.E. 849, 854 acknowledged was a property tax) to be invalidly applied to foreign insurers. 272 U.S. at 515-16. However, this Court *upheld* the validity of another Illinois tax that was a gross premiums *privilege* tax which Illinois had imposed in 1919 *only* on foreign insurers. 272 U.S. at 503-04, 510-11, 512, 514-15. The taxpayer had already been admitted to do business in Illinois when the 1919 tax was enacted. See *Hanover* Transcript of Record, October Term 1926, docket No. 179, pp. 32, 44; *Hanover Fire Ins. Co. v. Carr* (1925) 317 Ill. 366, 148 N.E. 23, 24. By the different treatment accorded the two types of taxes in *Hanover*, *Hanover* serves to emphasize the distinction between *privilege* tax cases (such as the current case) and *property* tax cases (such as the cases relied upon by Western and Southern).

For the reasons given above it is respectfully submitted that the decision of the California Court of Appeal should be affirmed.

Dated: December 18, 1980.

Respectfully submitted,

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**(Appendices Follow)**

## *Appendix A*

### California Constitutional and Statutory Provisions

*Retaliatory Tax:*

Article XIII, section 14-4/5, subdivision (f)(3), as amended in 1964 and as it was in effect for the years 1965 through 1971, provided as follows: '

> (3) When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this state; so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or

country within the meaning of this paragraph (3) of subdivision (f).

The provisions of this paragraph (3) of subdivision (f) shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this paragraph (3) of subdivision (f).

For the purposes of this paragraph (3) of subdivision (f) the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States.

In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

The provisions of this paragraph (3) of subdivision (f) shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.

California Insurance Code sections 685 through 685.4, as enacted in 1959, and as they have existed without change ever since, provide as follows:

§ 685.

When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit re-

quirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this State, so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this article.

§ 685.1.

This article shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or

personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this article.

§ 685.2.

For the purposes of this article the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States. In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

§ 685.3.

To the extent permitted by the Constitution of this State there is hereby imposed upon the commissioner the duty of enforcing the execution of the provisions of Section 685. It shall be the duty of the commissioner to initiate the enforcement and execution of the provisions of Section 685 in request to all matters which by the Constitution or laws of this State require further or final action by other officials of this State. In respect to any matter initiated by the commissioner, it shall be the duty of the Board of Equalization, Board of Control and State Controller to complete the enforcement and execution of the provisions of Section 685 in respect to such matter within the scope of the duties and powers of each as set forth in the Constitution and laws of this State.

§ 685.4.

The provisions of this article shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.

*Gross Premiums Tax, Principal Office Deduction:*

Article XIII, section 14-4/5, subdivision (e), as amended in 1964 and as it was in effect for the years 1967 through 1971, provided as follows:

> (e) (1) Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.
>
> (2) In the event a portion of the real property described in paragraph (1) of this subdivision is occupied by a person or persons other than the insurer the deduction granted the insurer by said paragraph shall be limited to that percentage, not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January

1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this paragraph, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(3) The phrase "person or persons other than the insurer" as used in paragraph (2) of this subdivision shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities. The Legislature may define the terms used in this paragraph for the sole purpose of facilitating the operation of this paragraph.

California Revenue and Taxation Code section 12241, as amended in 1967 and as it was in effect for the years 1967 through 1971, provided as follows:

§ 12241.

(a) Each insurer shall have the right to deduct from the tax imposed by this chapter upon an insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

(b) In the event a portion of the real property described in subdivision (a) is occupied by a person or persons other than the insurer the deduction granted the insurer by said subdivision shall be limited to that percentage not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this section, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(c) The phrase "person or persons other than the insurer" as used in subdivision (b) of this section shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities.

## *Appendix B*

The following are all the state statutes which provide for a retaliatory tax; all are "comparative" retaliatory statutes:

Code of Ala. 1975 § 27-3-29 (1977); Alaska Stat. § 21.09.270 (1966); Ariz. Rev. Stat. § 20-230 (1977); Ark. Stat. § 66-2225 (1961); Cal. Ins. Code §§ 685-685.4 (1959); Colo. Rev. Stat. 1973 § 10-3-209(2) (1973); Conn. Gen. Stat. § 12-211 (1965); Del. Code Ann. tit. 18, § 531 (1953); Fla. Stat. Ann. § 624.429 (1969); Ga. Code Ann. § 56-321 (1960); Idaho Code § 41-340 (1961); Ill. Ins. Code § 444 (Smith Hurd Ill. Ann. Stat. ch. 73, § 1056) (1941); Indiana Code § 27-1-20-12 (1937); Iowa Code Ann. § 505.14 (1955); Kan. Stat. Ann. § 40-253 (1967); Ky. Rev. Stat. Ann. § 304.3-270 (1970); La. Rev. Stat. § 22:1079 (1970); Me. Rev. Stat. Ann. § 24-A-428 (1973); Md. Ann. Code art. 48A, § 61 (1971); Mass. Ann. Laws ch. 175, § 159 (1922); Mich. Stat. Ann. § 24.1476 (1948); Minn. Stats. Ann. § 60A.19, subd. 6 (1971); Miss. Code §§ 27-15-121 through 27-15-127 (1964); Mo. Ann. Stat. § 375.916 (1967); Mont. Rev. Code § 40-2826 (1959); Neb. Rev. Stat. § 44-150 (1959); Nev. Rev. Stat. § 680A.330 (1971); N. H. Rev. Stat. § 400-A:35 (1971); N.J. Stat. Ann. § 17:32-15 (1950), § 17B:23-5 (1971); N.M. Stat. § 59-5-36 (1978) (insurance brokers), § 59-5-57 (1978) (insurance agents); N.Y. Ins. Law § 61 (1973); N.C. Gen. Stat. § 58-152 (1945); N.D. Century Code § 26-01-05 (1943); Ohio Rev. Code Ann. § 3905.41 (1953), § 5729.06 (1953); Okla. Stat. Ann. tit. 36, § 628 (1957); Ore. Rev. Stat. § 731.854 (1967); 40 Pa. Cons. Stat. Ann. § 50 (1974); R.I. Gen. Laws § 27-2-17 (1956); Code of Laws of S.C. § 38-5-480 (1976); S.D. Cod. Laws § 58-6-70 (1978); Tenn. Code Ann. § 56-4-218 (1979); Vernon's Ann.

Texas Stat., Ins. Code art. 21.46 (1957); Utah. Code Ann. 31-14-9 (1963), Vt. Stat. Ann. tit. 8, § 3367 (1967); Va. Code § 38.1-87 (1952); Wash. Rev. Code Ann. § 48.14.040 (1947); W. Va. Code Ann. § 33-3-16 (1957); Wis. Stat. Ann. § 76.66 (1979), § 76.67 (1979); Wyo. Stat. § 26.1-77 (1967).

The years given with the above citations show the date of enactment or date of most recent amendment or reenactment.

Supreme Court, U.S.
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NO. 79-1423

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

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On Appeal from the Court of Appeal,
Second Appellate District, State of California

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## REPLY BRIEF FOR THE APPELLANT

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**On Appeal from the Court of Appeal, Second Appellate District, State of California**

## REPLY BRIEF FOR THE APPELLANT

## INTRODUCTION

Appellant, the Western and Southern Life Insurance Company ("Western and Southern") hereby submits its Reply to the Brief of the Appellee, State Board of Equalization of the State of California (the "Board") and to the briefs *amici curiae* filed in support of the Board's position.[1]

[1] *Amicus* briefs include the Brief *Amicus Curiae* of American Insurance Association, National Association of Independent Insurers, The

Western and Southern acknowledges that the Board's brief correctly points out typographical errors in the printing of California Constitution Article XIII Section 14-4/5, sub-paragraphs (e) and (f) (3) in the Statutory Appendix of the "Brief for the Appellant;" those sections are correctly reproduced in the addendum hereto, beginning on page 1a.

## I. THE EFFECT OF WESTERN AND SOUTHERN'S CALIFORNIA LICENSE.

The first issue addressed by the Board is whether California may impose discriminatory conditions upon Western and Southern after its receipt of its license for an indefinite term. (Board brief, p. 8-10)

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Alliance of American Insurers and State Farm Mutual Automobile Insurance Company (the Property Insurers' brief); the *Amicus* Brief of the State of Tennessee (Tennessee brief); the Brief for States of Arizona and Wisconsin as *Amici Curiae* (Arizona, Wisconsin brief), and the Brief *Amicus Curiae* of the American Council of Life Insurance (ACLI brief). Since Appellant has been advised by the Clerk that this Court will not determine until after the submission of this Reply whether it will permit the ACLI brief to be filed, pertinent portions of that brief are addressed herein. In the Property Insurers brief, counsel erroneously suggests to this Court (Statement, p. 2-3) that it has been misled concerning the non-discriminatory character of Ohio laws taxing foreign insurance companies and attempts to prove such contention by citing Ohio law and depositing with the clerk what he calls "copies of Appellant's recent returns." Aside from the impropriety of trying to prove facts in this Court unsupported by the record and the irrelevance of discrimination by Ohio under the California retaliatory tax provisions at issue in this case, the California courts have twice found that Ohio does not discriminate in general against foreign insurers (*Western and Southern* v. *State Board of Equalization*, 4 Cal. App. 3d 21, 84 Cal. Rptr. 88 (1970); *Western and Southern* v. *State Board of Equalization*, Superior Court, Los Angeles County, #C3189, Conclusions of Law, Joint Appendix, p. 75). Moreover, the materials lodged with the clerk pursuant to footnote 1 of the Property Insurers' brief are work papers of an Ohio Department employee, not Western and Southern tax returns.

The stipulated facts are that Western and Southern was issued a license to do business in California in 1956 for an indefinite term. It did not have to apply for a new license every year, although the license required the company to continue to comply with California law.

It is clear that out-of-state insurers which have established businesses in a state under an indefinite or unequivocal license are entitled to the protection of the equal protection clause against discriminatory taxation (See Brief *Amicus Curiae* of Life Insurance Council of New York ("LICONY BRIEF") at p. 6-7). As the California Court of Appeal in *Atlantic Insurance Co.* v. *State Board of Equalization,* 255 Cal. App. 2d 1, 62 Cal. Rptr. 784 (1st Dist. 1967) said:

> . . . California, unlike most states, grants certificates of authority to transact insurance business for an indefinite period subject to payment of a $10 annual fee. . . . A certificate is not granted until the applicant conforms to requirements of California law prerequisite to its issue. After such issue the insurer must continue to comply with requirements of law. . . .
>
> Unlike insurers who must obtain an annual license to conduct business, appellants appear to have obtained "unequivocal" licenses to do business. The fact that the California certificates of authority could be revoked for failure to pay taxes or to otherwise comply with the law (Ins. Code, Section 701) does not alter that position. (*Hanover Fire Ins. Co.* v. *Harding, supra,* 272 U.S. 494, is said to stand for the proposition that once a foreign corporation has been unconditionally admitted to do business in a state it must be granted equal protection. (272 U.S. at p. 514.) (255 Cal. App. 2d at 13-14, 62 Cal. Reptr. at 792).

The Board has abandoned its original argument (Reply to *Amicus Curiae* Brief of the United States, filed September 25, 1980, p. 4-5) that Western and Southern's license

was "conditional" (*i.e.*, not unequivocal) and hence within the ambit of *Lincoln Life Insurance Co.* v. *Read,* 325 U.S. 673 (1945), which held equal protection inapplicable in the case of a conditional license. This Court could justifiably remove any distinction between "conditional" and "unequivocal" licenses and hold that the same constitutional protections are available to both kinds of licenses. If it chooses not to do so, however, it is clear that Western and Southern's indefinite license falls with the scope of *Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 (1926), and thus within the exception recognized in *Lincoln* and that Western and Southern is entitled to equal protection. As this Court stated in *Lincoln* in carving out cases where equal protection applies:

> We can put to one side such cases as *Hanover F. Ins. Co.* v. *Harding* . . ., where-a-foreign insurance company, having obtained an unequivocal license to do business in Illinois and built up a business there, was subsequently subjected to discriminatory taxation. . . . appellant, unlike the foreign corporation in *Hanover F. Ins. Co.* v. *Harding,* never obtained from Oklahoma an unequivocal license to do business there; it agreed to pay not only for the renewal but also for the retention of its annual license such taxes as Oklahoma might impose. (*Supra,* p. 676)

Since Western and Southern had been admitted into California on an indefinite license, it was entitled to all the protections of the Constitution, including guarantees against interference with interstate commerce to the extent not authorized by the McCarran-Ferguson Act. Furthermore, as the Board now acknowledges (Board brief, p. 9), Western and Southern cannot be required to submit to a violation of its due process and equal protection rights. Whether the retaliatory tax is such a violation will be determined by this Court.

## II. THE EFFECT OF THE McCARRAN-FERGUSON ACT.

The Board urges that the McCarran-Ferguson Act as construed by this Court gives California blanket authority to impose any retaliatory tax it may wish without regard to the commerce clause (Board brief, p. 11-20). In reaching this conclusion the Board would give this Court's opinion in *Prudential* v. *Benjamin,* 328 U.S. 408 (1946), the broadest possible construction, arguing that the McCarran Act freed all state taxation, discriminatory or not, (and regardless of impact) from commerce clause restraints. This Court, however, carefully circumscribed the scope of its decision in *Prudential* v. *Benjamin* and stressed that it was expressing no opinion concerning the validity of any of the myriad of state taxing statutes not substantially identical with the particular South Carolina statute involved.

*Prudential* v. *Benjamin* did not even deal with a retaliatory tax, although such a tax was one of three taxes considered by the Supreme Court of Kansas in *In Re Insurance Tax Cases,* 160 Kan. 311, 161 P. 2d 734 (1945), affirmed *per curiam* by this Court (*Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 822 (1946)). The Kansas Court was unable to find on the record before it any evidence that foreign insurers were taxed more heavily than domestic insurers. This Court affirmed on that record, without undertaking either an examination of the discriminatory impact of the particular retaliatory tax involved, or the discriminations involved in a multi-state pattern of retaliatory taxes.

Apart from commerce clause considerations, it is clear that neither *Prudential* v. *Benjamin* nor any other decision of this Court has passed on the question whether Congress also sought by enacting the McCarran Act to remove equal protection clause restrictions on the power of the states to discriminate against foreign insurers. The McCarran Act is

directed solely to the commerce clause. There is no suggestion that it was directed to any of the restrictions imposed by the equal protection clause on state taxation of foreign insurers. This Court has held to the contrary (*State Board of Insurance* v. *Todd Shipyards,* 370 U.S. 451, 457 (1962)).

Foreign insurers which have established businesses in a state under indefinite licenses were held under the pre-McCarran Act decisions to be protected by the equal protection clause of the Fourteenth Amendment. The imposition by a state of more onerous tax burdens on such foreign insurers than on the state's domestic corporations for the privilege of conducting an insurance business was held to constitute a denial of equal protection of the laws (*Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 (1926); *Southern Railway Co.* v. *Greene,* 216 U.S. 400, 418 (1910); accord: *WHYY, Inc.* v. *Borough of Glassboro,* 393 U.S. 117, 119 (1968)). Western and Southern having established its insurance business many years ago under an unequivocal license to do business in California as construed by the California courts could not have been subjected, under the pre-McCarran Act cases, to more onerous taxes than those imposed on California domestic insurance companies. The retaliatory tax here involved which would have been repugnant to the equal protection clause before the adoption of the McCarran Act remains repugnant to that clause after the adoption of the Act.

## III. RETALIATORY TAXES DO NOT SECURE COMITY, UNIFORMITY OF TAXATION OF FOREIGN INSURERS NOR EVEN-HANDED TREATMENT OF FOREIGN INSURERS.

The Board and *amici* supporting the California retaliatory tax urge that retaliatory taxes are intended to secure comity, uniformity of taxation by the states of foreign insurers and even-handed treatment by the states of foreign insurers. More than a century's experience with retaliatory taxes dispels these contentions.

The concept of comity as it is generally understood plays no part in the retaliatory taxation of foreign insurance companies. It is suggested by *amicus* ACLI that comity "implies that the foreign state not merely end discrimination against the legislating state's corporations but accept the legislating state's own standards as controlling for that state's corporations" (ACLI brief, p. 22). This, however, distorts the principles of comity. Comity implies a respect by one state of the laws of another state and comprises an acknowledgment that separate governmental entities legislate based upon their unique needs and public policies. Comity is a willingness to grant a privilege out of deference and good will, not as a matter of right. *See e.g., Dow* v. *Lillie,* 26 N.D. 512, 144 N.W. 1082, 1088 (1914).

Retaliatory taxes do not evoke even the spirit of comity, for the principle which undergirds the retaliatory tax system is that one state may try to impose its insurance tax structure upon another state. Contrary to any sense of respect, such pressure is in disrespect of the laws of the other state which should be free to peg taxes on insurance companies on the basis of local revenue needs. If the legislature of the other state does not respond by reducing

its taxes on foreign insurance companies, a penalty is imposed by the taxing state not upon the other state but upon the insurers of such other state.

As presently constituted, retaliatory taxes permit revenue-rich states to dictate to revenue-poor states the level of taxation of foreign insurance companies to be imposed by the revenue-poor states. Revenue-poor states are thus urged to forego insurance tax revenues in order to protect their domestic insurers from retaliatory taxes. *See* Brief of the State of New York as *Amicus Curiae* (p. 2-3). Retaliatory taxes rest on the misguided assumption that states should not be permitted to generate insurance tax revenues in a manner most suitable to their individual revenue needs. Implicit in retaliatory taxes is that the taxing state knows better what the ceiling should be on the taxation of foreign insurance companies by other states.

If, as is suggested by ACLI in the brief, it is comity for one state to force its laws upon other states, then Oklahoma is the only state having a retaliatory tax to achieve comity, for all Oklahoma insurers are taxed at a 4% rate on business they do in the other 46 states having retaliatory taxes. Such a concept of comity is contrary to the assertion that retaliatory taxes result in uniformity of taxation of foreign insurance companies or that they generally tend to keep down state premiums tax rates on foreign insurance companies.

Nor have retaliatory taxes resulted in uniformity in the taxation of foreign insurance companies by the states. The ACLI brief, referring to Appendix B of the LICONY brief, suggests that most states tax the premiums of foreign insurance companies at 2% and that this bespeaks the efficacy of retaliatory taxes to achieve uniformity in the taxation of foreign insurance companies (ACLI brief, p. 27). The Board's brief is more precise, pointing with pride to

the fact that "twenty-six states share the same exact rate of 2%" (Board brief, p. 34). Similarly the Property Insurers' brief comments on uniformity by pointing out that "[t]hirty-six states and the District of Columbia impose gross premiums taxes of between 2 and 2.5 percent on out of state property and casualty insurers" and that "[a]pproximately half of the states have settled on 2 percent as the appropriate level of taxation" (Property Insurers' brief, p. 22).

These observations reflect the lack of uniformity in the 47 states having retaliatory taxes. Looking only at those 47 states, an examination of Appendix B of the LICONY brief reveals that 24 of the 47 states tax some or all of the premiums of foreign life insurance companies at rates different from 2%. Similarly, an examination of Appendix B of the Property Insurers' brief indicates that 24 of the 47 states tax the premiums of foreign property and casualty insurance companies at rates different from 2%. There are numerous other significant variations in the premium taxation of life insurance companies by the states and in the way retaliatory taxes are computed in the states having such taxes. *See* LICONY brief, p. 20-22. The lack of uniformity is patent. More than a century of experience with retaliatory taxes has not only failed to achieve nationwide uniformity, but has produced a chaotic patchwork of confused and often discriminatory tax laws applicable to insurance companies. There is little likelihood that further experience will improve matters to any degree.

Nor have retaliatory taxes resulted in the even-handed treatment of foreign insurance companies by the 47 states having retaliatory taxes. Looking only at Appendix B of the LICONY brief, is it even-handed for all Oklahoma life insurance companies to pay a 4% premimus tax on any business they do in the other 46 states having retalia-

tory taxes or for all Ohio life insurance companies to pay premiums taxes at a rate of at least 2.5% on any business they do in the other 46 states having retaliatory taxes, especially when insurers from low-tax (revenue-rich) states generally pay the prevailing foreign company rate of tax on any business they do in the other states having retaliatory taxes? If that is even-handedness, it is decidedly horizontal and works its greatest disfavor upon the insurance companies of the high-tax (revenue-poor) states. Even-handedness is better achieved on a vertical basis where all insurance companies of a given type (*e.g.*, all life insurance companies), or at least all foreign insurance companies of a given type, competing for business within a state are taxable at the same rate and, therefore, contend with the same relative tax burden.

It has been suggested that the fact that only 17 states levy higher premiums taxes on foreign insurance companies than are levied by California demonstrates the effect of California's retaliatory tax in establishing uniformity in the treatment of California insurers and, specifically, that "[t]hirty-two states afford California insurers the same or better treatment than that [2.35%] which California offers" (ACLI brief, at page 27). Retaliatory taxes cut two ways. The very fact that only 17 states (including the three states — Hawaii, New Mexico and North Carolina — having no general retaliatory tax) levy higher taxes on foreign life insurance companies than California levies also means that California life insurance companies are subject to retaliatory taxes in the 32 other states which levy lower taxes (without regard to retaliatory taxes) on foreign life insurance companies than California's 2.35% rate. Thus, retaliatory taxes result in the uniform taxation of California life insurance companies in 32 states, but to their competitive disadvantage in each and every case.

Retaliatory taxes evidence a high level policy which is inconsistent with our federal system.[2] States, especially revenue-poor states, should not be compelled to pit their tax rates against the tax rates of other states.

## CONCLUSION

Both California tax provisions which Western and Southern is challenging should be declared unconstitutional because they are fundamentally wrong. The denial of the home office deduction to some, but not all, foreign insurers denies due process and equal protection. The retaliatory tax penalizes some to the advantage of others; and, make no mistake, those who have the advantage are greater in number and are its proponents; those such as Western and Southern who bear the penalty are in the minority.

The judgment of the Court of Appeal of the State of California, Second Appellate District, should be reversed, and the judgment of the Superior Court of California for the County of Los Angeles should be reinstated.

Respectfully submitted,

Alan R. Vogeler

Attorney for the Appellant,
The Western and Southern
Life Insurance Company

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[2] The Property Insurers' brief (p. 23-26) cites examples of federal tax provisions which empower the President to increase taxes on citizens and corporations of foreign countries depending upon taxes in those countries. It asks ". . . why should the same purpose and the same means be denied to the 47 states having retaliatory laws?" The answer is that the states of the Union are not foreign governments and that the sense of the commerce and equal protection clauses of the Constitution is that states are not to treat each other as foreign countries nor to deny equal protection to corporations from other states doing business within their borders.

## ADDENDUM

California Constitution, Article XIII, § 14-4/5 (e) :

(e) Deductions.

(e) (1) Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

(2) In the event a portion of the real property described in paragraph (1) of this subdivision is occupied by a person or persons other than the insurer the deduction granted the insurer by said paragraph shall be limited to that percentage, not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real propery upon which construction of the home office or principal office of the domestic insurer commenced prior

to January 1, 1970. As used in this paragraph, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(3) The phrase "person or persons other than the insurer" as used in paragraph (2) of this subdivision shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities. The Legislature may define the terms used in this paragraph for the sole purpose of facilitating the operation of this paragraph.

California Constitution, Article XIII, § 14-4/5 (f):

(3) When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this state; so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other

obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this paragraph (3) of subdivision (f).

The provisions of this paragraph (3) of subdivision (f) shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this paragraph (3) of subdivision (f).

For the purposes of this paragraph (3) of subdivision (f) the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States.

In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

The provisions of this paragraph (3) of subdivision (f) shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.

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## OBJECTION TO MOTION OF THE AMERICAN COUNCIL OF LIFE INSURANCE FOR LEAVE TO FILE BRIEF AMICUS CURIAE

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Appellee.

## OBJECTION TO MOTION OF THE AMERICAN COUNCIL OF LIFE INSURANCE FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Appellant, the Western and Southern Life Insurance Company (Western and Southern), opposes the motion of the American Council of Life Insurance (the Council) for leave to file a brief *amicus curiae* on the following grounds:

1. The brief does not represent the position of a significant portion of the members of the Council.
2. The brief may not represent the position of a majority of the life insurance companies in the country.

3. The views of the insurance industry have been presented by the *amicus* brief of American Insurance Association, National Association of Independent Insurers, The Alliance of American Insurers and State Farm Mutual Automobile Insurance Company in support of Appellee, to which filing Western and Southern has consented.

Western and Southern is a member of the Council and, as the Court can well imagine, Western and Southern not only takes complete issue with the points asserted in the brief, but also dissented from the Council's decision to submit a brief on the merits in the first instance. Among other reasons, Western and Southern withheld consent because it objects to the expenditure of resources by its trade association to express a viewpoint upon which the membership of the organization holds no unanimity of view and because the decision to file a brief was made by a majority of a committee of the Council composed of only 21 members and not by the entire membership.

There are deep-rooted doubts among many Council members as to the propriety of the Council's submitting a brief which takes a position contrary to the perceived interests of a substantial number of the Council's members. The Council's motion states that its members are the "beneficiaries of the protection provided by their own states' retaliatory tax, and all of its members are beneficiaries of the relatively uniform system of state insurance premiums taxation fostered thereby." (Motion for Leave to File, p.2) These statements represent at best the opinion of a few influential members of the committee of the Council; Western and Southern certainly has not been the beneficiary of any such system. On the contrary, in California alone, for the years in issue, Western and Southern has been penalized to the extent of $977,853.57.

The Council represents to this Court that it is "peculiarly able to present to the Court the views of the insurance industry regarding the retaliatory tax statutes." (Motion for Leave to File, p.2) Western and Southern takes issue with this presumptuous assertion. As noted above, the Council cannot even represent the views of *all* its own members, much less those of the insurance industry on a nationwide basis. The views of the members of the Council who are also members of the Life Insurance Council of New York (four of whom are among the 12 largest companies in the country, and all of whom together collect approximately 20% of insurance premiums business in the country) are not represented by the Council's brief, the 53-member New York trade association having filed with consent of the parties, a brief *amicus curiae* in support of Western and Southern's position. Finally, the Council has only 509 members (Motion for Leave to File, p.1), while according to Best's Insurance Reports — Life — Health (1980), there were 1957 legal reserve life insurance companies qualified to do business in the United States and the District of Columbia at December 31, 1979. The Council does not speak for at least 75% of the members of the life insurance industry.

In short, there is sharp division within the nationwide life insurance industry as to what outcome would be in the best interests of the industry, and Western and Southern urges the Court to recognize this fact.

Finally, Western and Southern would point out to the Court that the issues covered by the Council's brief are addressed by the brief of Appellee, the State Board of Equalization of the State of California, as well as by three briefs *amicus curiae* already on file with the Court without objection from Western and Southern.

For these reasons the Council's motion to file its brief *amicus curiae* should be denied.

Respectfully submitted,

. . . . . .

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MOTION FILED

No. 79-1423

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

*Appellee.*

**On Appeal From the Court of Appeal Second Appellate District, State of California**

## MOTION FOR LEAVE TO FILE AND BRIEF *AMICUS CURIAE* OF AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF APPELLEE

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

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**No. 79-1423**

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

*Appellee.*

---

**On Appeal from the Court of Appeal Second Appellate District, State of California**

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## MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* FOR THE AMERICAN COUNCIL OF LIFE INSURANCE

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The American Council of Life Insurance (the "Council") hereby moves, pursuant to Rule 36.3 of the Rules of this Court, for leave to file the attached brief as *amicus curiae*. The appellee has consented to the filing of such a brief. The appellant has refused consent.

As described in the brief (*infra*, pp. 1, 2), the Council is a trade association consisting of 509 life insurance companies including most of the major life insurers in the United States. Its members, collectively, have in force approximately 95% of the life insurance written in the United States and 95% of the

life insurance written in California. Many of its members are required to pay retaliatory taxes, such as the tax involved in this case, in California and elsewhere. Most of its members are the beneficiaries of the protection provided by their own state's retaliatory tax and all of its members are beneficiaries of the relatively uniform system of state insurance premiums taxation fostered thereby.

Because the Council has a nationwide constituency, it is peculiarly able to present to the Court the views of the life insurance industry regarding the retaliatory tax statutes in effect in California and 46 other states. The Council and its membership are particularly concerned that neither the parties, on the one hand, nor *amici* on behalf of appellant, Life Insurance Council of New York[1] and the United States, on the other, have addressed or will address certain facts and arguments. Most important among these omissions are those arguments which show why, on a national scale, the retaliatory statutes of California and other states represent a valid and useful element in the nation's scheme of taxation of insurance companies. The Council also wishes to advance the proposition, not presented by the parties, that the McCarran Act, 59 Stat. 33, 15 U.S.C. §§1011-1015, gives a Congressional imprimatur of rationality to the classifications drawn by the California statute.

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[1] Consent for filing the brief *amicus curiae* of the Life Insurance Council of New York was granted by both appellant and appellee.

For these reasons, the motion for leave to file the attached brief *amicus curiae* should be granted.

Respectfully submitted,

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

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**No. 79-1423**

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

*Appellee.*

---

**On Appeal From the Court of Appeal Second Appellate District, State of California**

---

## BRIEF *AMICUS CURIAE* OF AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF APPELLEE

---

## INTEREST OF *AMICUS CURIAE*

The American Council of Life Insurance is a trade association consisting of 509 life insurance companies including most of the major life insurers in the United States. Its members, collectively, have in force approximately 95% of the life insurance written in the United States and 95% of the life insurance written in California.

Many of its members are required to pay retaliatory taxes, such as the tax involved in this case, in California and elsewhere. Most of its members are the beneficiaries of the protection provided by their own state's retaliatory tax law, and all of its members are beneficiaries of the relatively uniform

system of state insurance premiums taxation fostered thereby. This brief is devoted solely to the retaliatory tax issue; it urges the affirmance of the judgment of the court below.

## STATEMENT

This case involves California's so-called "retaliatory" tax imposed, in this instance, on premiums collected by an insurance company incorporated in the State of Ohio. California Ins. Code, Section 685.

Retaliatory taxes, in some form, exist in at least 47 states (J.A. at 82). The California retaliatory tax applies only to insurers incorporated in the 17 states which place higher tax burdens upon California insurers than those imposed by California (Brief for Appellant at 13). It does not apply to insurers from California or the 32 states which do not impose taxes on California insurers more burdensome than those imposed by California. Where applicable, the retaliatory tax exacts, in the aggregate, the same taxes and fees from out-of-state insurers that their states of incorporation exact from California insurers.

Appellant, an Ohio corporation, was admitted to do business in California in 1956 under a conditional Certificate of Authority of indefinite term (J.A. at 4, 43). That certificate is expressly conditioned upon compliance by appellant with applicable laws and requirements as such laws are in effect or as they may be amended or changed (J.A. at 43).

Appellant is subject to the California retaliatory tax because Ohio, its state of incorporation, exacts from California insurers taxes and fees more onerous than those California would exact from Ohio insurers but for the retaliatory law. Appellant complains that this exaction (1) interferes with the power Congress has over interstate commerce, U.S. Constitution, Art. I, Sec. 8, cl. 3, and (2) denies it the equal protection of the laws by discriminating against it without a rational basis. The California Court of Appeal, Second Appellate District, from which this appeal is taken, disagreed with appellant on both points.

## SUMMARY OF ARGUMENT

### I.

The California retaliatory tax cannot violate the commerce clause, either in letter or in spirit. Congress, in the exercise of its power to regulate commerce among the several states, may not only promote such commerce but may constrict or entirely prohibit it. It may exercise its power itself or in coordination with the states. *Lewis v. BT Investment Managers, Inc.*, No. 79-45, decided June 9, 1980; *Prudential Ins. Co. v. Benjamin,* 328 U.S. 408, 434. Through the McCarran Act, 59 Stat. 33, 15 U.S.C. §§ 1011-1015, Congress exercised, in complete coordination with the states, its power to regulate and tax the business of insurance. *Prudential Ins. Co. v. Benjamin,* 328 U.S. at 434-436. Therefore, whether or not an insurance retaliatory tax actually discriminates, it is impervious to a commerce clause attack. *Prudential Ins. Co. v. Benjamin,* 328 U.S. at 436; *Prudential Ins. Co. v. Hobbs,* 328 U.S. 822, *reh. denied,* 329 U.S. 819 (insurance retaliatory tax).

### II.

Since Congress, through the McCarran Act, has acted to sustain and reinforce California's insurance retaliatory tax by the exercise of all the remaining legislative power residing in our federal system, explicit and compelling constitutional infirmity must be found before this joint federal-state effort can be invalidated. *Prudential Ins. Co. v. Benjamin,* 328 U.S. at 436. Such explicit and compelling infirmity cannot be found by resort to the equal protection clause of the Fourteenth Amendment.

First, appellant was not admitted to do business in California under an *unequivocal* license; it was admitted under a *conditional* license of indefinite term (J.A. at 43). Because payment of the tax at issue here is necessary to fulfill a condition to which appellant agreed to be bound upon initial entry and is required for the retention of its license, such payment constitutes a continuing condition of admission,

regardless of the term of appellant's license to do business. *Western & Southern Life Ins. Co. v. State Bd. of Equalization,* 4 Cal.App.3d. 21, 31, 84 Cal.Rptr. 88, 94-95 (1970); *see Lincoln Life Ins. Co. v. Read,* 325 U.S. 673; *Philadelphia Fire Ass'n v. New York,* 119 U.S. 110. It has long been established that the equal protection clause permits a state to discriminate against foreign corporations by imposing upon them more onerous conditions of admission than it imposes upon domestic companies. *Asbury Hospital v. Cass County,* 326 U.S. 207, 212; *Lincoln Life Ins. Co. v. Read,* 325 U.S. 673, 677-678; *Hanover Fire Ins. Co. v. Harding,* 272 U.S. 494, 510-511; *Philadelphia Fire Ass'n v. New York,* 119 U.S. 110. *Philadelphia Fire Ass'n v. New York, supra,* explicitly held that equal protection would not be offended by a foreign corporation's compliance with a retaliatory insurance tax (substantially identical to the tax at issue here) triggered *after* the foreign corporation's admission to do business in the retaliatory state. Unless *Philadelphia Fire Ass'n v. New York* is to be overruled and *Lincoln Life Ins. Co. v. Read* ignored, the equal protection clause does not forbid California to collect its retaliatory tax from appellant.

Second, the California retaliatory tax is not susceptible to attack on equal protection grounds because the classifications it draws are reasonable. Because of a state's broad discretion in making classifications, particularly in taxing statutes, and because of this Court's natural reticence to sit as a "super-legislature," it is appellant's burden to negative every conceivable basis which might support the classifications drawn by the California tax. *See, e.g., Madden v. Kentucky,* 309 U.S. 83, 88. Appellant has not carried its burden. Its argument that a classification scheme in a state taxing statute based solely on a corporation's state of incorporation is virtually a *per se* equal protection violation is not only wrong, *Allied Stores of Ohio v. Bowers,* 358 U.S. 522; *Metropolitan Casualty Ins. Co. v. Brownell,* 294 U.S. 580, it is also irrelevant. California's retaliatory tax discriminates against only those corporations from the 17 states who levy insurance premiums taxes against California corporations at a rate in excess of California's (Brief for Appellant at 13). It has no present effect on foreign corporations from 32 other states.

The reason California's tax does not discriminate against *all* foreign corporations (such as the taxes struck down in *WHYY, Inc. v. Glassboro,* 393 U.S. 117, *Wheeling Steel Corp. v. Glander,* 337 U.S. 562, *Southern Ry. v. Greene,* 216 U.S. 400, and other cases cited in appellant's support) is the same reason that the classifications drawn by the tax are rational: the purpose of the tax is to induce states not to tax California insurers more than, in the absence of the retaliatory tax, California would tax their insurers. *E.g., Western & Southern Life Ins. Co. v. State Bd. of Equalization,* 4 Cal.App.3d 21, 34, 84 Cal.Rptr. 88, 96 (1970); In re *Insurance Tax Cases, Aetna Ins. Co. v. Hobbs,* 160 Kan. 300, 161 P.2d 726, 730 (1945), *aff'd sub nom. Prudential Ins. Co. v. Hobbs,* 328 U.S. 822 (*per curiam*). Given this legitimate goal of seeking comity, it would be irrational for California *not* to discriminate as it does.

California's classification scheme is no different than a number of similar discriminatory classifications inherent in a variety of other reciprocating retaliatory and reciprocal statutes. This essential, widespread and hitherto acceptable form of interstate cooperation is one of the few methods of achieving relative national uniformity of state legislation, where appropriate, without resorting to the time-consuming complexity of fashioning and adopting uniform laws or interstate compacts or attracting detailed federal involvement. Because Congress itself, through the McCarran Act, has given the retaliatory tax an imprimatur of rationality, this Court should refrain from renting this tightly woven fabric of interstate cooperation for the sake of plucking from the Fourteenth Amendment a federal "system of delusive exactness" and imposing it where it does not belong.

## ARGUMENT

### I. The California Retaliatory Tax Does Not Interfere with the Power of Congress to Regulate Interstate Commerce Since Congress Has Exercised That Power by Authorizing the Tax.

There can be no mistaking the lesson of *Prudential Ins. Co. v. Benjamin,* 328 U.S. 408. The power of Congress to grant

protection to interstate commerce against state regulation or taxation or to withhold such protection is complete. The determination of policy made by Congress must prevail. *State Bd. of Ins. v. Todd Shipyards Corp.*, 370 U.S. 451, 456. Congress may not only promote interstate commerce, it may prohibit it entirely or adopt restrictions thereon between either extreme. Nothing (outside of explicit provisions such as are contained in Art. I, § 9 of the Constitution) forbids Congress from discriminating against interstate commerce and in favor of local trade. *Prudential Ins. Co. v. Benjamin,* 328 U.S. at 434 (*see* cases cited at fns. 44 and 45). In so doing, Congress may either act alone or it may act in concert with the states. *Id.* In either case, the ordinary negative implications of the commerce clause as regards a state's power to regulate commerce are irrelevant. *Id.*

This lesson was reiterated by a unanimous Court as recently as the closing days of last term:

> Congress, of course, has power to regulate the flow of interstate commerce in ways that the States, acting independently, may not. And Congress, if it chooses, may exercise this power indirectly by conferring upon the States an ability to restrict the flow of interstate commerce that they would not otherwise enjoy. *Prudential Ins. Co. v. Benjamin,* 328 U.S. 408, 423-424 (1946) [other citations omitted].

*Lewis v. BT Investment Managers, Inc.*, No. 79-45, decided June 9, 1980.

*Prudential Ins. Co. v. Benjamin, supra,* and a case decided on its authority a week later, *Prudential Ins. Co. v. Hobbs,* 328 U.S. 822, it is respectfully submitted, control this case.

*Prudential Ins. Co. v. Benjamin* involved the power of Congress to validate a South Carolina statute which exacted a premiums tax from foreign insurance corporations when there was no similar levy against South Carolina corporations. The Court, after a thorough and carefully crafted discussion of Congress's power over interstate commerce, its ability to exercise that power in coordination with the states, and its exercise thereof in the McCarran Act, 59 Stat. 33, 15 U.S.C. §§ 1011-

1015, declared that the tax could not violate the commerce clause, in letter or spirit, whether or not the tax was in fact discriminatory:[1]

> In this light the argument that the degree of discrimination which South Carolina's tax has involved, *if any,* puts it beyond the power of government to continue must fall of its own weight. [Emphasis added.]

328 U.S. at 436.

The essential holding of the case was that Congress, through the McCarran Act, had exercised its power under the commerce clause "in complete coordination" (328 U.S. at 435) with the states to sustain extant and future state regulation and taxation of insurance. Whether that state regulation and taxation promoted interstate commerce or discriminated against it (or, for that matter, prohibited it) was irrelevant because each such regulation or tax (or at least those of a type known to the Congress which enacted the McCarran Act[2]) had the full,

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[1] The Supreme Court of South Carolina apparently concluded that Prudential had failed to show that the premiums tax, levied solely against foreign corporations, was discriminatory "in net effect" since property taxes paid by domestic corporations had not been considered. *See Prudential Ins. Co. v. Murphy*, 207 S.C. 324, 331, 355 S.E.2d 586, 588 (1945). The basis of the conclusion appears to have been that because domestic corporations were more likely to have greater amounts of property in South Carolina subject to South Carolina property taxes than were foreign corporations, it was possible that the total tax collected by South Carolina from domestic corporations and foreign corporations was more nearly equal than it appeared from consideration of the premiums tax alone. As its opinion makes clear, this Court concluded that this finding was irrelevant.

[2] Of course the existence of retaliatory insurance taxes was well known to the 79th Congress. They were a long established part of the fabric of American state taxes on insurance companies. In the period immediately following this Court's *Southeastern Underwriters* decision, 322 U.S. 533, but before the enactment of the McCarran Act, 13 or 14 states repealed their retaliatory laws. J. Pyle, "The Metamorphic Retaliatory Tax Law (What Lies Ahead?)," 23 Ass'n of Life Insurance Counsel Proc. 857, 897 (1972); G. Pelletier, "Insurance Retaliatory Laws," 39 Notre Dame Lawyer 243, 249 (1964). As of April 1945, 34 states had some form of insurance retaliatory tax. Note, "Congressional Consent to Discriminatory State Legislation," 45 Colum. L. Rev. 927, 930, fn. 15 (1945). Thus, it is clear that restoring the status quo to retaliatory tax legislation was a part of the over-all McCarran Act agenda.

combined force of the federal and the state governments behind it, a combined force that, because of the very fact of the combination, makes it impervious to commerce clause infirmities (unless, of course, the subject of the regulation or tax is not commerce).

*Prudential Ins. Co. v. Hobbs*, 328 U.S. 822, *reh. denied*, 329 U.S. 819, dealt with a similar attack by foreign corporations on the insurance tax scheme of Kansas. The tax primarily at issue in that case was what has been characterized by the courts below in this case as a "comparative" retaliatory tax, a tax whose retaliatory effect is felt so long as the foreign state's rate is higher than the legislating state's, without regard to discrimination by the foreign state between its own domestic corporations and others. Not coincidentally, this Kansas retaliatory tax has been held by the highest authority in California to be "substantially identical" to California Insurance Code § 685, the tax at issue here. *Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 99 Cal.App.3d 410, 424, fn. 3, 159 Cal.Rptr. 539, 542, fn. 3 (1979) (J.A. at 89); *Atlantic Ins. Co. v. State Bd. of Equalization*, 255 Cal.App.2d 1, 10, 62 Cal.Rptr. 784 (1967). In *Prudential v. Hobbs* the Court upheld the retaliatory tax against a commerce clause attack in a *per curiam* affirmance of the Kansas court, relying upon *Prudential v. Benjamin*. Like *Prudential v. Benjamin*, therefore, *Prudential v. Hobbs* stands for the proposition, in the retaliatory insurance tax realm, that, discriminatory or not, state taxes on the business of insurance are granted virtual commerce clause immunity by the McCarran Act.

Finally, it is clear that this was the understanding and intention of those who drafted and enacted the McCarran Act in 1945. During the course of the debate, Senator Ferguson of Michigan, one of the sponsors of the bill, said:

> The language of the bill makes clear the purpose of the legislation, that the taxation problem will be taken care of, and there will be no excuse for paying under protest or not paying at all.

91 Cong. Rec. at 504 (1945). A short time later in the debate, Senator O'Mahoney of Wyoming said:

> We are extending to the States, complete immunity for their State tax law. . . .

91 Cong. Rec. at 509 (1945). And, finally, Senator McCarran himself most succinctly stated the Act's purpose:

> In other words, we give to the States no more powers than those they previously had, *and we take none away from them.*

91 Cong. Rec. at 1442 (1945); emphasis added.

By "previously" it is clear that the Senator meant previous to the Court's decision in *United States v. Southeastern Underwriters Ass'n,* 322 U.S. 533. Prior to that decision, it was "generally accepted doctrine" (*see* S. Rep. No. 20, 79th Cong., 1st Sess. (1945)) that the business of insurance was not "commerce" and thus it, and taxes on it, were not affected by the commerce clause.

Congress clearly thought that it was validating taxes exactly like the tax involved in this case. There is no reason why Congress would not have the valid constitutional power to carry out that intention. That is what this Court held in *Prudential Ins. Co. v. Benjamin,* and specifically with respect to a retaliatory tax in *Prudential Ins. Co. v. Hobbs.* There is no reason now to depart from those contemporaneous and carefully considered decisions.

## II. The California Retaliatory Tax Is Not Invalid Under the Equal Protection Clause.

Once Congress, in complete coordination with California, has acted to sustain the tax, reinforcing it by the exercise of all the legislative power of government residing in our federal system, substantial constitutional infirmity must be found before this joint effort can be invalidated (*Prudential Ins. Co. v. Benjamin,* 328 U.S. 408, 435-436):

> Clear and gross must be the evil which would nullify such an exertion, one which could arise only by exceeding beyond cavil some explicit and compelling limitation im-

posed by a constitutional provision or provisions designed and intended to outlaw the action taken entirely from our constitutional framework.

The equal protection clause was not the explicit, compelling limitation the Court had in mind. An equal protection clause argument was made in *Prudential Ins. Co. v. Benjamin*, 328 U.S. at 437. With respect to this and related arguments, this Court said (328 U.S. at 437-438):

> These arguments may be summarily disposed of. As for the due process contention, it was settled by a long line of authorities prior to the *Southeastern* decision, that the similar provision of the Fourteenth Amendment, *as well as that requiring equal protection of the laws,* does not forbid the states to lay and collect such a tax as South Carolina's. Certainly the Fifth Amendment does not more narrowly confine the power of Congress; nor do it and the Fourteenth taken together accomplish such a restriction upon the coordinated exercise of power by the Congress and the states. [Footnote omitted; emphasis added.]

Thus, it is clear that the California statute does not exceed "beyond cavil" the equal protection clause proscription. The question was recognized and settled in the *Prudential Insurance* cases, and the California statute here is no more discriminatory than the South Carolina statute before the Court in *Prudential v. Benjamin* or the Kansas statute involved in *Prudential v. Hobbs.* There is no acceptable basis for upsetting what has been settled law and practice in this fiscal-commercial area for thirty-five years since the McCarran Act, and for well over a hundred years in the business and financial practice of the country. *See* Note, "Congressional Consent to Discriminatory State Legislation," 45 Colum. L. Rev. 927 (1945).[3]

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[3] *See also Indianapolis Brewing Co. v. Liquor Control Comm'n*, 305 U.S. 391; *Finch & Co. v. McKittrick*, 305 U.S. 395. These opinions are among the last written by Mr. Justice Brandeis, and evidence his usual penetrating thought. They are a virtually contemporaneous construction of the Twenty-First Amendment, and they are an added showing that when the protection of the commerce clause is taken away, rational discriminatory regulations present no substantial question under other provisions of the constitution, including the equal protection clause.

### A. It Has Never Been Held That a State May Not Exact From a Foreign Corporation as a Condition to Continued Admission to Do Business the Payment of a Tax Measured by the Business Done Within Its Borders.

Appellant and *amici* in support of appellant do not perceive the fine though pivotal distinctions in cases such as *Asbury Hospital v. Cass County,* 326 U.S. 207, *Lincoln Life Ins. Co. v. Read,* 325 U.S. 673, *Hanover Fire Ins. Co. v. Harding,* 272 U.S. 494, and *Philadelphia Fire Ass'n v. New York,* 119 U.S. 110 (Brief for the Appellant at 14-17; Brief for the United States as *Amicus Curiae* at 9; Brief *Amicus Curiae* in Support of Appellant on Behalf of the Life Insurance Council of New York [hereinafter "LICONY Brief"] at 6-7). Those cases do not stand for the proposition that a state's grant of a conditional, *indefinite* license to conduct business immediately brings a foreign corporation into the same class, for Fourteenth Amendment purposes, as domestic corporations. *Lincoln,* 325 U.S. at 676; *Hanover,* 272 U.S. at 515. As is clear from *Lincoln,* 325 U.S. at 676-678, the fact that a license is of an *indefinite* term is not relevant; it is the fact that a license grants a foreign corporation an *unequivocal* or *unconditional* right to conduct business in the discriminating state that vaults that corporation into the same class occupied by domestic corporations.[4]

In the instant case, California has granted no such unconditional or unequivocal license to appellant. Indeed, appellant's certificate to conduct business in California states that such admission is "expressly conditioned" upon conformance with California taxing laws as in effect upon initial entry and as amended (J.A. at 43). Accordingly, to paraphrase the Court in *Lincoln,* 325 U.S. at 676, appellant, unlike the foreign corporation in *Hanover, supra,* never obtained from California an unequivocal license to do business there; it agreed to pay for the retention of its license such taxes as California might impose.

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[4] *Asbury Hospital v. Cass County,* 326 U.S. at 212, goes even further by holding that state legislation imposing greater burdens on foreign corporations than those to which they were subject at the time of their entry is acceptable on the ground that the state might exclude the foreign corporations altogether at a later date. *See also Baltic Mining Co. v. Massachusetts,* 231 U.S. 68. Application of this broad rule, however, is unnecessary in this case.

Because payment of the tax at issue here is a prerequisite for retention of its license, appellant is not admitted within the state or within its jurisdiction until it pays such license fee. It is outside, at the threshold, seeking admission. *Lincoln*, 325 U.S. at 678; *Philadelphia Fire Ass'n*, 119 U.S. at 119. Indeed, in another case involving the application of the California insurance retaliatory tax to this very appellant, the California Court of Appeal precisely so held. *Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 4 Cal.App.3d 21, 31, 84 Cal.Rptr. 88, 94-95 (1970). "And the equal protection clause does not require the tax or rate of tax exacted from a foreign corporation as a condition of entry to be the same as that imposed on domestic corporations." *Lincoln*, 325 U.S. at 678; *Hanover*, 272 U.S. at 510-511.

To employ the equal protection clause to defeat the California retaliatory tax not only runs roughshod over this basic principle but requires the overruling of *Philadelphia Fire Ass'n, supra*. That case, expressly relied upon in and explained by *Lincoln v. Read, supra*, and *Prudential v. Benjamin*, 328 U.S. at 438, fn. 50, explicitly upheld, against an equal protection attack, the imposition of a "comparative" retaliatory insurance tax provision such as the tax at issue here upon a corporation that had already gained admission to the retaliating state. The New York retaliatory tax upheld in that case lay dormant as regards Pennsylvania corporations until Pennsylvania imposed a premiums tax applicable to New York insurance companies operating in Pennsylvania that was higher than New York's tax. This occurred many years after the appellant Pennsylvania corporation first qualified to do business in New York. The retaliatory levy, so awakened, was not an unconstitutional discrimination, however, because the original New York retaliatory law which provided for its possible later triggering by Pennsylvania in effect *conditioned* the original grant of a license to the Pennsylvania corporation.

In this case, appellant is in an identical if not worse position. Subjection to some form or at least the constitutional threat of a California retaliatory tax conditioned appellant's license from the day it was first granted; it was not a dormant

condition awakened by the action of the legislature of another state after appellant had done business in California for years without feeling its threat.[5] Therefore, unless "the long established rule that a State may discriminate against foreign corporations by admitting them under more onerous conditions than it exacts from domestic companies [is to] go into the discard," *Lincoln,* 325 U.S. at 677, the imposition of the California tax on appellant must be upheld.

**B. The Classifications Established by the California Legislature to Secure Comity and to Promote Uniformity of Taxation Are Reasonable.**

Even if *Philadelphia Fire Ass'n, supra,* is to be overruled and *Lincoln v. Read, supra,* and *Asbury Hospital v. Cass County, supra,* disregarded, the California insurance retaliatory tax is not susceptible to attack on equal protection grounds because the classifications it draws are reasonable.

1. *In Taxation and Economic Regulation, Even More Than in Other Fields, State Legislatures Possess Wide Freedom in Classification.*

So long as "suspect classifications" or "fundamental rights" are not involved, a state possesses wide latitude in making classifications and drawing lines in distributing benefits and burdens through the legislative process. That discretion is at its broadest (and has long been so) where a state legislature describes classifications in the field of taxation and economic

[5] The California Constitution, Art. XIII, § 14-4/5, subdiv. (f)(3) has long provided for retaliatory insurance premiums taxes. Although the California constitutional provision regarding its retaliatory tax was changed slightly in 1964, the statutory provision (first enacted in 1873, Stats. 1873, Ch. 610, § 18, repealed in response to *U.S. v. Southeastern Underwriters,* Stats. 1945, Ch. 921, and then re-enacted as Insurance Code § 685 *et seq.* in 1959) was not. *Western & Southern Life Ins. Co. v. State Bd. of Equalization,* 99 Cal.App.3d 410, 413, 159 Cal.Rptr. 539, 541, (1979) (J.A. at 83). Because of the statute's conflict with the state constitution prior to 1964, however, Western & Southern, in other actions, successfully sued for a refund of retaliatory taxes assessed against it prior to 1964 (J.A. at 5). *See Western & Southern Life Ins. Co. v. State Bd. of Equalization,* 4 Cal.App.3d at 25, 84 Cal.Rptr. at 91 (1970).

regulation. *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359; *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 526-527; *Madden v. Kentucky*, 309 U.S. 83, 88; *State Bd. of Tax Commissioners v. Jackson*, 283 U.S. 527, 537; *Citizens' Telephone Co. v. Fuller*, 229 U.S. 322, 329; *Bell's Gap R.R. v. Pennsylvania*, 134 U.S. 232, 237. As this Court stated in *Allied Stores of Ohio v. Bowers*, 358 U.S. at 526-527, and reiterated, in part, in *Lehnhausen v. Lake Shore Auto Parts*, 410 U.S. at 359-360:

> The States have a very wide discretion in the laying of their taxes. When dealing with their proper domestic concerns, and not trenching upon the prerogatives of the National Government or violating the guaranties of the Federal Constitution, the States have the attribute of sovereign powers in devising their fiscal systems to ensure revenue and foster their local interests. Of course, the States in the exercise of their taxing power are subject to the requirements of the Equal Protection Clause of the Fourteenth Amendment. But that clause imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation. . . . "To hold otherwise would be to subject the essential taxing power of the State to an intolerable supervision, hostile to the basic principles of our Government and wholly beyond the protection which the general clause of the Fourteenth Amendment was intended to assure." *Ohio Oil Co. v. Conway, supra*, 281 U.S. at 159.

As was shown above at pages 5-9, the California retaliatory tax, by virtue of the McCarran Act, 15 U.S.C. §§ 1011-1015, is a coordinated exercise of federal and state power over commerce. *Prudential v. Benjamin*, 328 U.S. at 433-436. This voluntarily cooperative effort of Congress and a state in taxing insurance premiums can hardly be one "trenching upon the prerogatives of the National Government." The question presented thus is distilled to the single question whether it appears from the application of the California retaliatory tax to appellant that California's legislature and the Congress together

have proceeded upon a rational basis or, instead, have resorted to a classification that is "palpably arbitrary." *Allied Stores of Ohio v. Bowers,* 358 U.S. at 530.

2. *The Classifications Drawn by the California Tax Must Be Upheld Unless No State of Facts Can Be Conceived Which Support Them.*

In making the determination whether the classifications made by the retaliatory tax are rational, "[t]he burden is on the one attacking the legislative arrangement to negative *every conceivable basis* which might support it." [Emphasis added.] *Madden v. Kentucky,* 309 U.S. at 88. If "any state of facts reasonably can be conceived that would sustain it," even though discriminatory, the classification must be upheld. *Allied Stores of Ohio v. Bowers,* 358 U.S. at 528.

In deciding whether "every conceivable basis" has been parried by appellant, the Court should be loath to judge the efficacy or even the ultimate fairness of the tax. As the Court stated in *State Bd. of Tax Commissioners v. Jackson,* 283 U.S. 527, 537-538, a case involving a tax which discriminated against chain stores:

> It is not the function of this Court in cases like the present to consider the propriety or justness of the tax, to seek for the motives or to criticize the public policy which prompted the adoption of the legislation. Our duty is to sustain the classification adopted by the legislature if there are substantial differences between the occupations separately classified. Such differences need not be great. The past decisions of the Court make this abundantly clear.

As Mr. Justice Frankfurter once wrote, "Wise tax policy is one thing; constitutional prohibition quite another." *Newark Fire Ins. Co. v. State Bd. of Tax Appeals,* 307 U.S. 313, 323.

This reticence to "sit as a super-legislature," *see Colgate v. Harvey,* 296 U.S. 404, 441 (Brandeis, Stone, and Cardozo, JJ., *dissenting), overruled, Madden v. Kentucky,* 309 U.S. 83, 93, has long prevailed in this Court when it has been called upon to judge the validity of legislative classifications under the equal

protection clause. The Court has long heeded its own admonition, expressed in *Louisville & Nashville R. R. v. Barber Asphalt Co.*, 197 U.S. 430, 434, that "it is important for this court to avoid extracting from the very general language of the Fourteenth Amendment a system of delusive exactness" and has wisely refused to read into its flexible and constantly developing Fourteenth Amendment jurisprudence a frozen and "lifeless logic."[6] *See, e.g., Metropolitan Casualty Ins. Co. v. Brownell,* 294 U.S. 580 (upholding discrimination favoring domestic corporation over foreign corporation).

3. *A Classification Scheme Discriminating Between Foreign and Domestic Corporations Does Not Necessarily Offend Equal Protection.*

Though not directly at issue here,[7] and despite appellant's claim that the contrary rule is "well established" (Brief for the Appellant at 18), classification based simply on a corporation's state of incorporation does not violate the equal protection clause. *Metropolitan Casualty Ins. Co. v. Brownell,* 294 U.S. 580. Indeed, discrimination both in favor of foreign corporations and against them has been upheld by this Court against equal protection assaults. *Metropolitan Casualty Ins. Co. v. Brownell, supra* (against); *Allied Stores of Ohio v. Bowers,* 358 U.S. 522 (in favor).

*Metropolitan Casualty Ins. Co., supra,* upheld an Indiana statute that discriminated against foreign insurance companies and in favor of domestic ones by forbidding the former to limit by agreement to less than three years the time within which suit might be brought against them on their contracts. A domestic

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[6] "Legislation is essentially empiric. It addresses itself to the more or less crude outside world and not to the neat, logical models of the mind. Classification is inherent in legislation; the Equal Protection Clause has not forbidden it. To recognize marked differences that exist in fact is living law; to disregard practical differences and concentrate on some abstract identities is lifeless logic." *Morey v. Doud,* 354 U.S. 457, 472 (Frankfurter and Harlan, JJ., *dissenting*), *overruled, New Orleans v. Dukes,* 427 U.S. 297, 306 ("*Morey* was the only case in the last half century to invalidate a wholly economic regulation solely on equal protection grounds, and we are now satisfied that the decision was erroneous.")

[7] *See* pages 19-22, *infra.*

corporation could set any reasonable limit it wished. The mere fact that Indiana distinguished between corporations solely on the basis of their state of incorporation (in order to favor its own), however, was not dispositive.

> The ultimate test of validity is not whether foreign corporations differ from domestic, but whether the differences between them are pertinent to the subject with respect to which the classification is made. [Citation omitted.] If those differences have any rational relationship to the legislative command, the discrimination is not forbidden. [Citations omitted.]

294 U.S. at 583. Because it was "not beyond the range of probability" that foreign companies were more likely than domestic companies to keep their funds, and maintain their business offices and their agencies for the settlement of claims outside of Indiana,[8] and because the Court "[could] not say that these considerations may not have moved the legislature to insist that a longer time should be given for bringing suit against foreign companies than [against domestic companies]," 294 U.S. at 585-586, the Court held the discrimination against foreign corporations valid under the equal protection clause.

*Allied Stores of Ohio v. Bowers,* 358 U.S. 522, is to like effect in a situation where foreign corporations are the beneficiaries of discriminatory classification between corporations based solely on their state of incorporation. In that case nonresidents were exempted from an Ohio *ad valorem* tax on warehoused merchandise (held for storage only) which Ohio corporations were forced to pay. Because "it may reasonably have been the purpose and policy of the State Legislature, in adopting the proviso, to encourage the construction or leasing

[8] The Court itself stated, 294 U.S. at 583, 585, however, that there was no basis in the record, briefs, or arguments on which the Court could rely to make a determination that foreign corporations even were likely to keep their funds and maintain their businesses outside of Indiana, nor need there have been.

and operation of warehouses in Ohio by nonresidents with the attendant benefits to the State's economy," 358 U.S. at 528-529, the discriminatory foreign/domestic classification was upheld.[9]

Even in realms where, unlike the situation here, unacceptable burdens on interstate commerce might appear to be at issue, at least tangentially, such that the commerce clause might seem to cast its shadow across the Fourteenth Amendment, the Court has not been deterred from applying its ordinary "any conceivable basis" equal protection analysis in tax cases. In *Madden v. Kentucky,* 309 U.S. 83, an *ad valorem* tax levied against property owned by Kentucky citizens was five times greater on out-of-state bank deposits than on those kept in Kentucky. Despite its obvious impediment to the flowering of interstate banking this discrimination withstood an equal protection attack. Likewise, *Citizens National Bank v. Durr,* 257 U.S. 99, upheld against equal protection and commerce challenges an Ohio statute that taxed its citizens on the value of their membership on the New York Stock Exchange while exempting from taxation memberships on local exchanges.

Similarly, in *State Bd. of Tax Commissioners v. Jackson,* 283 U.S. 527, it was alleged that an annual license tax on stores

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[9] The fact that a foreign corporation was benefitted by the discrimination, *i.e.*, interstate commerce was encouraged, does not distinguish the case, for equal protection purposes at least, from *Metropolitan Casualty, supra,* where a foreign corporation was harmed (and interstate commerce discouraged). For equal protection purposes it is the rationality of the discriminatory classification alone that matters, not whether other policies inherent in other parts of the Constitution, such as the protection of interstate commerce in the absence of Congressional action (not relevant here by virtue of Congressional action, *see* pages 5-9, *supra*), might be involved. Here, where other Constitutional policies are, by act of Congress, explictly *not* involved, it is especially imperative not to let commerce clause considerations (that might appear pertinent were it not for that act of Congress) color the separate equal protection analysis.

*Hanover Fire Ins. Co. v. Harding,* 272 U.S. 494, and *Southern Ry. v. Greene,* 216 U.S. 400, are not to the contrary since each involved a discrimination against foreign corporations which could not be supported by any conceivable state of facts based on differences arising from differing places of incorporation. The discriminatory tax in each case appeared to be simply an exaction for raising revenues for maintenance of the government, *see, e.g.,* 272 U.S. at 497, the services of which were not required appreciably more by one class of corporation than by the other.

increasing progressively with the number of stores under the same general management or ownership, but which ignored income, sales or investment, was blatant discrimination against chain stores. It seems implicit in that opinion that discrimination against chain stores could result in *de facto* discrimination against foreign corporations and interstate commerce. But the great deference accorded state legislatures in making classifications for taxing purposes made it impossible for the Court to declare the classification arbitrary and unreasonable and thus the equal protection challenge was denied.

4. *The Classification Scheme of the Retaliatory Tax Is Intended to Secure Comity or Reciprocal Treatment and Is, Therefore, Rational and Not Arbitrary.*

Even simple and plain discrimination against all foreign corporations and in favor of domestic corporations, as shown above, is not a *per se* denial of equal protection; the domestic versus foreign classification may readily be justified. Were a California tax to draw such a distinction, we submit that it too could be readily justified. *Cf. Prudential v. Benjamin, supra; Metropolitan Casualty, supra.*

The most cursory analysis of the operation and goals of the California retaliatory tax reveals, however, that the retaliatory tax does not simply favor domestic corporations over all foreign corporations. The distinctions it draws are between corporations from states which impose premium taxes on California insurers at a rate higher than California's, on the one hand, and all other insurers, foreign or domestic, on the other. As appellant itself points out (Brief for Appellant at 13) the retaliatory tax applies only to foreign insurers incorporated in the 17 states which place higher tax burdens upon insurers than California. Insurers from California and 32 other states, therefore, are treated the same.[10]

The operative fact that puts appellant into the disfavored class, therefore, is not appellant's Ohio incorporation, but rather

[10] This distinguishes this case from *WHYY, Inc. v. Glassboro*, 393 U.S. 117, where a New Jersey statute providing a tax exemption for non-profit corporations discriminated against *all* foreign corporations for no apparent reason more weighty than administrative ease.

Ohio's higher premiums tax. If Ohio were to reduce its rate to match California's (at least for California corporations) appellant would no longer be subject to any greater burden than that imposed on the insurers from California and 32 other states. The solution for any harm suffered by appellant, therefore, lies with the Ohio legislature. As this Court said in a case construing the privileges and immunities clause of the Fourteenth Amendment, *Austin v. New Hampshire,* 420 U.S. 656, 668:

> Nor... can the constitutionality of one State's statutes affecting nonresidents depend upon the present configuration of the statutes of another State.

The source of appellant's injury aside, the fact that the "discrimination" inherent in the retaliatory tax is limited to and focused upon a small and discreet class carved out of the class of all foreign corporations is essential to an understanding of the goal of the retaliatory tax and the rationality of the classification drawn to achieve that goal. The thrust of the retaliatory tax is not simply to favor local insurance companies while penalizing foreign insurers. Were that the goal California would impose an additional tax on corporations from 49 states, not just 17.

The purpose of the tax and the classification it draws is to secure equitable or favorable treatment for California corporations doing business in other states; in the words of the California Court of Appeal, "to secure ... even-handed treatment by the Legislatures of other states," *Western & Southern Ins. Co. v. State Bd. of Equalization,* 4 Cal. App. 3d at 34, 84 Cal. Rptr. at 96 (1970) (construing the post-1964 "comparative" retaliatory tax), and "to secure reciprocity," *Atlantic Ins. Co. v. State Bd. of Equalization,* 255 Cal. App. 2d 1, 62 Cal. Rptr. 784, 793 (1967), *appeal dismissed, cert. denied,* 390 U.S. 529. The retaliatory tax "is designed to achieve uniformity of treatment and not to discriminate." *Id.*

Other courts and commentators construing identical or similar statutes have agreed. *Occidental Life Ins. Co. v. Commonwealth,* 6 Pa. Comwlth. 532, 295 A.2d 853, 854 (1972) ("The purpose of a retaliatory charge is to bring about equality

of treatment."); *Republic Ins. Co. v. Commissioner of Taxation,* 272 Minn. 325, 138 N.W. 2d 776 (1965); *Commissioner of Ins. v. Equity General Ins. Co.,* 346 Mass. 233, 191 N.E.2d 139, 142 (1963); In re *Insurance Tax Cases, Aetna Ins. Co. v. Hobbs,* 160 Kan. 300, 303-304, 161 P.2d 726, 730 (1945), *aff'd sub nom. Prudential Ins. Co. v. Hobbs,* 328 U.S. 822 (*per curiam*)[11]; *Pacific Mutual Life Ins. Co. v. Lowe,* 354 Ill. 398, 188 N.E. 436 (1933); *Life and Casualty Ins. Co. v. Coleman,* 233 Ky. 350, 353, 25 S.W. 2d 748, 749 (1930); *Clay v. Dixie Fire Ins. Co.,* 168 Ky. 315, 181 S.W. 1123, 1125 (1916); 52 Harv.L.Rev. 172 (1938); Couch, ON INSURANCE (2d), § 21:92 and cases therein cited; 19 Appleman, INSURANCE LAW AND PRACTICE, § 10352 (1946, Supp. 1979).

This desire for "even-handed treatment" is not only the paramount, it is the only purpose of a retaliatory tax. Unlike the tax at issue in *Hanover Fire Ins. Co. v. Harding,* 272 U.S. 494, a retaliatory tax does not have even an ancillary revenue-raising purpose.

> In fact, its success might be said to depend on how little is collected under its terms rather than how much. It is designed to bring about equality of treatment between domestic and foreign corporations and to break down interstate barriers.

*Commonwealth v. Fireman's Fund Ins. Co.,* 369 Pa. 560, 564, 87 A.2d 255, 258 (1952). *See also Pacific Mutual Life Ins. Co. v. State,* 161 Wash. 135, 296 P. 813 (1931). Because the purpose

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[11] The Kansas Supreme Court, in construing a tax which the California Court of Appeal has held "substantially identical" to the tax at issue here (*see* page 8, *supra*) discussed one of its earlier holdings:

> In the opinion [*Phoenix Insurance Co. v. Welch* ] (29 Kan. 674, 675) the court took note of the fact that the provision in question is referred to in insurance circles as "a retaliatory" clause, and said:
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> "It seems to us more justly to be deemed a provision for reciprocity. It says, in effect, that while we welcome all insurance corporations of other states to the transaction of business within our limits, we insist upon a like welcome elsewhere .... It is, in brief, an appeal for comity; a demand for equality. As such, it is manifestly fair and just. It arouses no sense of injustice, and simply says to every other state in the Union: 'We will meet you on the basis of equality and comity, and will treat you as you treat us.' "

of California's retaliatory tax is to secure reciprocity and thus "break down interstate barriers," it is submitted that the discrimination against corporations from the states, such as Ohio, from whom California is attempting to secure reciprocity, is rational. That this discrimination occasionally favors domestic corporations over some foreign corporations does not render the classification scheme arbitrary and irrational. Indeed, it would be irrational not to discriminate on just the sort of basis adopted by California.[12]

For these same reasons, the distinction between "comparative" or "discriminatory" retaliatory laws cannot be dispositive. Comity, which implies that the foreign state not merely end discrimination against the legislating state's corporations but accept the legislating state's own standards as controlling for that state's corporations, is the guiding principle in either case.

5. *The California Retaliatory Tax Is Typical of Legislation Which Has Been Developed in the "Laboratories of the States"; It Is No Different Than Many Other Reciprocal and Retaliatory Statutes Designed to Make the Federal System Work More Smoothly.*

The attempts of states to secure "even-handed treatment" for their citizens and corporations living or operating in other states by securing treatment not necessarily enjoyed by citizens or corporations in those other states but deemed ordinary or

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[12] *Wheeling Steel Corp. v. Glander*, 337 U.S. 562, is not to the contrary. In that case Ohio argued that an alleged "reciprocity" provision whereby the intangibles of its residents were offered up to the taxing authorities of other states saved an Ohio *ad valorem* tax on intangibles that reached only nonresidents and exempted residents. This so-called "reciprocity" offer (which, the Court pointedly noted, was accepted by no state) was very different from the offer California makes here. In the *Wheeling Steel* situation, unlike the retaliatory tax scheme here, no other state could rescue its residents from the Ohio nonresident intangibles tax by altering its taxation of Ohioans. The Ohio tax on nonresidents was immutable. Ohio was not attempting to secure its citizens and residents reciprocal advantages; it was merely forsaking one revenue base for a larger one. Here, California's statute can be rendered wholly inoperative (as it already is to insurers from 32 states) when California's very real offer of reciprocity is accepted.

standard by the legislating state, are legion. While most examples are so-called "reciprocal" statutes, where the promise of favorable discrimination is exchanged in return for a like promise, several are "retaliatory," as the tax here is and as are insurance premiums taxes in most states (*See* LICONY Brief, Appendices B and C), where a penalty is threatened unless a benefit is granted.[13]

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[13] The distinction between "reciprocal" and "retaliatory" statutes is quite blurred. Because a "retaliatory" law such as is involved here provides that the so-called retaliation ends when a foreign state grants the benefit desired, it may also be perceived of as a "reciprocating retaliatory" law.

Because of this fact, the attempt by *amicus* Life Insurance Council of New York to distinguish retaliatory statutes from reciprocal statutes (LICONY Brief, at 10-14) is misleading. *Amicus* fails to point out that the thrust of each is identical. Both types of statutes intend to secure comity. Both types of statutes do so by invoking foreign versus domestic discrimination. In a retaliatory scheme (of the sort involved here, *i.e.*, a reciprocating retaliatory law) the foreign corporation or citizen is burdened more than the domestic only until the foreign state grants the benefit desired. At that point, the foreign state either lowers the tax rate applicable to all corporations, thus ending all discrimination, or begins to discriminate in favor of the legislating state's citizens or corporations and against its own. In the classic reciprocal case, discrimination by the legislating state against its own corporations and citizens in favor of those from a foreign state is offered in exchange for like discrimination by the foreign state. In the retaliatory case the legislating state ends the discrimination when the desired comity is afforded; in the classic reciprocal case the legislating state begins to discriminate when the desired comity is afforded. The only real difference is whether coercive, or persuasive and enticing, means are used to foster the desired mutual friendship. For equal protection purposes, the difference between coercive or persuasive means, the carrot or the stick, hardly seems dispositive since discriminatory classification exists in either.

Nor is "the essential difference" between reciprocal and retaliatory statutes, contrary to *amicus's* argument (LICONY brief at 13), "that in the absence of the so-called reciprocal feature the California retaliatory tax would clearly run afoul of the Equal Protection Clause whereas [benefits] that are granted to out-of-state charities or nonresidents on a reciprocal basis could be denied altogether." *Amicus* misses the point. The "so-called reciprocal feature" of the retaliatory tax is its very life-breath. The whole and only point of the tax is to act on corporations from states that do not reciprocate by favoring California corporations (or by taxing all insurers at the lower California rate). If a foreign state does not tax California insurers more than California does (*i.e.*, grants California insurers the benefit sought) there is no

(*footnote continues*)

Several states have retaliatory provisions demanding favorable treatment for their domestic building and loan or savings and loan associations.[14] A typical provision is found in South Dakota Cod. Laws Ann., section 52-11-7 (1980 Rev.):

> 52-11-7. *Laws of other states affecting South Dakota associations—Retaliatory statute applicable to foreign associations operating in this state.*
>
> When the laws of any other state impose taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations on savings and loan associations of this state doing business in such other state, as long as such laws continue in force the same obligations and prohibitions shall be imposed on the foreign associations doing business in this state and upon their agents herein.

Though some states term these statutes "reciprocal" they are no different in effect than the insurance "reciprocating retaliatory" law at issue here. The message is simple: we shall treat your corporations just as you treat ours. *See, e.g.*, Wash. Rev. Code, section 33.32.060:

> 33.32.060 *Reciprocity.* No foreign savings and loan association shall be permitted to do business in this state on more favorable terms and conditions than the associations organized under the laws of this state are permitted to do business in the state in which such foreign association or corporation is organized.

Some states have far-reaching retaliatory provisions in their professional licensing statutes. Iowa, for instance, requires

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(*footnote continued*)

retaliatory tax imposed; without the "so-called reciprocal feature," therefore, there is no retaliatory tax. This alleged "essential difference" distinguishing reciprocal from reciprocating retaliatory laws is mere abstraction and adds nothing to the analysis of the rationality of classifications in a retaliatory statute. *See, e.g., Employers Casualty Co. v. Hobbs,* 152 Kan. 815, 107 P.2d 715 (1940).

[14] Iowa Code Ann., § 534.62 (West Supp. 1980-81); Montana Rev. Codes Ann., § 7-135 (2d Repl. Vol. 1968); South Dakota Cod. Laws Ann., § 52-11-7 (1980); Vermont Stat. Ann., § 1941 (1970); Wash. Revised Code, § 33.32.060 (1979); Wisc. Stat. Ann., §§ 215.26, 215.33(b) (1980).

that any person licensed in another state wishing to practice a licensed profession in Iowa must meet every requirement and suffer every disability placed on Iowa licensees practicing in that other state. Iowa Code Ann. §§ 147.46, 147.52 (West 1972). To similar effect is Nebraska Rev. Stat. § 71-142 (1976 Reissue). Ohio has a retaliatory liquor tax with a similar impact. Page's Ohio Rev. Code §§ 4301.54, 4301.55 (1973).

Reciprocal statutes are too numerous to catalogue. In the field of taxation alone there are many. In addition to the reciprocal statutes discussed by *amicus* Life Insurance Council of New York (LICONY Brief, at 10-12) there are reciprocal tax exemptions such as South Carolina's provision which imposes a tax on out-of-state agricultural products but exempts them from all taxes and licenses provided the state from which such products came accords a similar privilege to the sales of South Carolina products within their boundaries. S.C. Code §§ 12-37-340, -350, -360 (1976); *see* 59 Harv.L.Rev. 1324 (1946). Like many "reciprocal" statutes, however, South Carolina's offer of reciprocity is really no more than an offer to end discrimination or retaliation against foreign products and not the offer of a mere favor for a favor since South Carolina's domestic agricultural products are wholly and unconditionally exempt from the South Carolina tax.

In addition to reciprocal tax benefits, many states' licensing statutes offer reciprocity. Lawyers, dentists, beauticians, and many types of licensed tradesmen may be admitted to practice in a state other than the one in which they originally qualified (though, perhaps, additional requirements, such as a minimum practice period, may be imposed) so long as that state returns the favor for licensed tradesmen of the second state.

Retaliatory and reciprocal statutes, it is clear from the briefest perusal of state codes, play an essential, widespread and long-accepted role in interstate cooperation. Their simplicity provides a path towards relative national uniformity, where appropriate, without resorting to the time-consuming complexity of fashioning a multitude of interstate compacts and without attracting the detailed involvement of the federal government. They are an accepted and essential way of life in

accommodating the need and desire for interstate harmony in our federal system. To rent this old but tightly woven fabric of interstate cooperation for the sake of imposing a federal "system of delusive exactness" where it does not belong would be a mistake.

6. *The Classifications Drawn by the California Retaliatory Tax Are Reasonably Designed To Accomplish Its Purpose; No Proof That the Tax Is Successful in Accomplishing Its Purpose Is Necessary.*

Given the purpose of the retaliatory law, it is obvious that the means chosen to accomplish that purpose is a rational one. In order for California to secure comity for its domestic insurers which operate in other states, the least discriminatory, yet effective, means it may employ is to penalize corporations from states with higher rates by exactly the amount by which those higher rates exceed California's. The closer to comity the other states move, the less the penalty exacted from each such state's corporations. The coercive or inducing effect is exactly tailored to the result desired.

Not only is it rational to suppose that, in this manner, the California retaliatory tax could gain legitimate benefits for California corporations, but it is also rational to suppose that the existence of a nationwide state retaliatory tax system could help achieve more generally uniform and reasonable premiums tax rates in all states. Indeed, it is not unlikely that the local insurance lobby will counter any proposal before a state legislature to raise insurance premiums tax rates radically by pointing out that, because of reciprocating retaliatory taxes, any increased revenues for the legislating state might be dwarfed by the resulting increased taxes thus made available to 40 or more other states. When the extraterritorial impact of such a rate increase is pointed out, and the implications that impact may have regarding the continued location of domestic insurance companies in the legislating state are realized, it is not irrational to conclude that a state legislature, if not moved to reduce rates to the national norm, will at least hesitate in raising them.

*Amicus* for appellant, The Life Insurance Council of New York, takes appellee to task, however, because California's

attempt to achieve comity for its insurers has not been 100% successful. (LICONY Brief, at 19-26.) This argument is not persuasive for at least two reasons.

First, California's attempt to achieve comity for its insurers has achieved, relatively speaking, remarkable success. By appellant's own count, only the insurers from 17 states are still subject to the retaliatory tax. (Brief for the Appellant at 13.) Thirty-two states afford California insurers the same or better treatment than that which California offers. Indeed, even if every state's insurance retaliatory tax were at issue, the remarkable relative uniformity of state taxation of premiums collected by foreign insurers (Appendix B to the LICONY Brief reveals that most rates hover around 2%) bespeaks the efficacy of the retaliatory tax laws in effect in nearly every state. *See Atlantic Ins. Co. v. State Bd. of Equalization, supra,* 62 Cal.Rptr. at 793.

Second, the efficacy of California's attempt to secure reciprocity need not be shown. As described above at pages 13-16, in the tax and economic fields if any state of facts reasonably can be conceived that would sustain the rationality of the classification, then even clearly discriminatory classification can withstand an equal protection attack. Even the fact that California might have furthered its underlying purpose more artfully, more directly, or more completely (a fact we do not concede) does not warrant a conclusion that the method it chose was unconstitutional. *Hughes v. Alexandria Scrap Corp.,* 426 U.S. 794, 813. In fact, so long as California's underlying assumption (that a contingent penalty exacted from Ohio insurers might induce Ohio to eliminate the contingency generating that penalty) is not irrational, California need not offer a scintilla of factual support for its assumption. *Hughes v. Alexandria Scrap Corp.,* 426 U.S. at 812; *Metropolitan Casualty Ins. Co. v. Brownell,* 294 U.S. at 583.[15]

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[15] As Professor Tribe summarized the showing necessary to support the "any conceivable basis" test of *Allied Stores of Ohio v. Bowers,* 358 U.S. at 528:

> This remarkable deference to state objectives has operated in the sphere of economic regulation quite apart from whether the conceivable "state of facts" (1) actually exists, (2) would convincingly justify the

(*footnote continues*)

7. *Congress Provided An Imprimatur of Rationality By Ratifying State Retaliatory Taxation of Insurance.*

At least in the realm of suspect classifications or fundamental rights, Congress may not authorize the states to violate the equal protection clause. *Shapiro v. Thompson,* 394 U.S. 618, 641. It may, however, by appropriate legislation, enforce the Fourteenth Amendment's guarantee of equal protection. Section 5 of the Fourteenth Amendment. In so doing, Congress may bring its specially informed legislative competence to bear to give shape and definition to the rights protected by the Fourteenth Amendment. *Katzenbach v. Morgan,* 384 U.S. 641, 648. While Congress, of course, does not have the final say as to what constitutes a rational classification for equal protection purposes, *cf. State Bd. of Ins. v. Todd Shipyards Corp.,* 370 U.S. 451, 457 ("Congress . . . does not have the final say as to what constitutes due process . . . ."), we submit that the McCarran Act gives an imprimatur of Congressional approval to the classification drawn by insurance retaliatory taxes and, therefore, those classification schemes should be accorded even more deference than usual.

As pointed out at footnote 2, page 7 above, numerous states had insurance retaliatory taxes at the time the McCarran Act was enacted, and had had them for many years. As is clear from floor debate and the published reports on that Act, one of the major thrusts of the Act was to permit each state to continue to collect the taxes it had long assessed against insurance companies on business within its borders, thus overcoming the objection that such taxes were unconstitutional after *United States v. Southeastern Underwriters Ass'n,* 322 U.S. 533. Since retaliatory taxation was an established part of the scheme of state taxation explicitly sanctioned, Congress, to the extent it may, gave the classification drawn thereby an imprimatur of rationality. Surely this was included in Senator McCarran's

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(*footnote continued*)

classification if it did exist, or (3) has ever been urged in the classification's defense by those who either promulgated it or have argued in its support.

L. Tribe, AMERICAN CONSTITUTIONAL LAW, § 16-3 (1978).

authoritative statement that "[w]e give to the states no more powers than they previously had, and *we take none from them,*" 91 Cong. Rec. at 1442 (1945); emphasis added. *See* p. 9, above.[16]

## CONCLUSION

The Court's natural bias in favor of "free trade" among the states, a legitimate bias when Congress is silent regarding the regulation of the "commerce" involved, has no place in this case. Congress, through the McCarran Act, has removed any negative commerce clause implications that might have pervaded the analysis of the constitutionality of state retaliatory taxes. *Prudential v. Benjamin, supra; Prudential v. Hobbs, supra.*

Once freed of that orientation, sound equal protection analysis must also validate the tax at issue here. Like any reciprocal statute, the California insurance retaliatory tax legitimately seeks to encourage the several states not to tax California insurers at rates higher than California imposes on them, and which it offers to all insurers; it is a request for comity. The fact that the inducement offered is through a penalty rather than a reward, apart from commerce clause principles that have no bearing here, is irrelevant. The classification the statute makes is essential to its legitimate purpose and is, therefore, rational.

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[16] The effect of the McCarran Act in this area is much the same as that of the Twenty-First Amendment with respect to the powers of the states over intoxicating liquor. *See Indianapolis Brewing Co. v. Liquor Control Comm'n,* 305 U.S. 391; *Finch & Co. v. McKittrick,* 305 U.S. 395, already cited at fn. 3, above.

The California statute violates neither the commerce clause nor the equal protection clause of the Federal constitution. For these reasons, the judgment of the Court of Appeal should be affirmed.

Respectfully submitted,

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,
*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
*Appellee.*

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**On Appeal from the Court of Appeal Second Appellate District, State of California**

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## BRIEF *AMICI CURIAE* OF AMERICAN INSURANCE ASSOCIATION, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, THE ALLIANCE OF AMERICAN INSURERS AND STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY IN SUPPORT OF APPELLEE

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This brief in support of appellee is submitted with the written consent of counsel to both parties filed with the Clerk of the Court.

### INTEREST OF THE *AMICI CURIAE*

The American Insurance Association, the National Association of Independent Insurers, and The Alliance of American Insurers are national trade associations representing more than 700 insurance companies writing property and casualty insurance throughout the United States, including New York, Ohio and California. State Farm Mutual Automobile Insurance Company, not a member of any of these associations, is the largest property and casualty insurer in the country. In 1979, the companies represented in this brief accounted for $69

billion of direct written premiums for property and casualty insurance—nearly 80 percent of the industry total—and paid state gross premiums taxes possibly totaling as much as $1.5 billion. In addition, in 1979 these companies paid state retaliatory taxes estimated to amount to $23 million out of an industry total of approximately $29 million.

Based on more than one hundred years of experience under a system of taxation which has included retaliatory taxes, the property and casualty insurance industry supports such taxes in the firm belief that they are an effective means of (1) restraining the states from imposing more burdensome or discriminatory forms of taxation, (2) maintaining substantial nationwide uniformity in premium tax rates and (3) thus enhancing the ability of insurance companies to do business on a national basis. Retaliatory taxation has proven effective because state legislatures, forewarned that increases in premiums taxes will result in retaliation against domestic insurers by other states, have proceeded with extreme caution before enacting any such increases.

## STATEMENT

With one significant exception, *amici curiae* generally concur in the statement of the case as set forth by the parties in briefs filed previously.

Contrary to what this Court has been told, Ohio *does* discriminate between foreign and domestic insurers. The trial court erroneously concluded that Ohio did not discriminate against California insurance companies during the "pertinent" years from 1965 to 1971. Joint Appendix at 75. This finding may have been the result of a stipulation by counsel for the parties, who actually agreed only that a *prior* case had found that Ohio did not discriminate during the tax years 1959 and 1960. Joint Appendix at 5. In any event, the trial court's "conclusion of law" is contrary to the actual situation existing in Ohio since at least 1933. *See Columbia Fire*

*Insurance Co.* v. *Tracy*, 133 N.E.2d 661, 662-63 (Ohio Ct. Com. Pl. 1953), *aff'd*, 139 N.E.2d 482 (Ct. App. 1954).

Ohio collects from each *foreign* insurance company a gross premiums tax of 2.5 percent. Ohio Rev. Code Ann. § 5729.03 (Page 1980). *Domestic* companies, on the other hand, are given an alternative of paying a separate franchise tax on the lesser of two bases. One alternative results in a tax exactly equivalent to the 2.5 percent gross premiums tax imposed on foreign insurers. *Id.* § 5725.18(B). The other involves a tax of three-tenths of one percent on the capital and surplus of a domestic insurance company calculated according to a formula set forth in the statute. *Id.* § 5725.18(A). Of course, Ohio domestic insurers will pay this latter tax whenever it results in a lower overall tax burden. It is common knowledge in the industry that this is frequently the case, and that in numerous instances the differential is substantial. Indeed, appellant's Ohio tax returns, on public file in Columbus, reveal that appellant itself has regularly taken advantage of the lower alternative tax.[1] This more favorable treatment is never available to foreign insurers.

For the convenience of the Court, the Ohio tax provisions are reprinted in Appendix A.

## SUMMARY OF ARGUMENT

State retaliatory taxation of insurance companies is not a novel form of taxation, or an aberration existing in only one state or region. More than a century old, it exists today in all but three states. Experience has demonstrated that retaliatory taxation is rational, workable and effective, and that it promotes, rather than hinders, the free trade values of the Commerce Clause.

[1] We have lodged with the Clerk of the Court copies of appellant's recent returns that were immediately available from the public file.

Strong concerns of federalism mandate that this system not be overturned by the Court.

## I

Congress, and this Court, authorized retaliatory taxation of insurance companies nearly 35 years ago, and nothing that has happened in the intervening years has undermined the validity of those judgments.

Retaliatory taxes were first enacted during a period when the insurance business was not considered a part of interstate commerce. *See Paul* v. *Virginia*, 75 U.S. (8 Wall.) 168 (1868). These were not protectionist taxes, but rather an attempt on the part of the states to encourage sister states to remove existing protectionist barriers. But retaliatory taxes, like all other forms of state insurance taxation, were thrown into doubt by the Court's historic decision in *United States* v. *South-Eastern Underwriters Association*, 322 U.S. 533 (1944), holding that insurance was subject to Congress' commerce power.

Congress responded immediately to head off the threat that state regulation and taxation of the insurance business would be invalidated or impaired by a wave of Commerce Clause litigation. By its language and structure, the 1945 McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1976), indicated that Congress intended to validate *all* kinds of state insurance taxation, including the retaliatory tax system that had been an integral feature of insurance taxation for more than half a century.

The legislative history of the McCarran Act fully confirms this purpose. The bill that eventually became the McCarran Act—prepared with substantial assistance from the insurance commissioners of the states—was introduced specifically to forestall court challenges to existing forms of taxation as burdens on interstate commerce. Passage of the bill was expedited because of Congress' concern that many insurers would refuse to

pay their state taxes. To ensure that its purpose would be fully effectuated, Congress even specified that its own silence was not to be construed as imposing any barrier to continued state taxation of insurance companies. 15 U.S.C. § 1011 (1976).

Nor was Congress' message misunderstood by this Court. In *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408 (1946), the Court sustained a South Carolina gross premiums tax levied only against foreign insurance companies. The Court held both that Congress had the power to authorize such discriminatory taxation and that Congress, through the McCarran Act, "clearly put the full weight of its power behind existing and future state legislation." *Id.* at 431. Any remaining doubt whether retaliatory taxes were included in this blanket authorization was dispelled one week later when the Court summarily affirmed a judgment of the Kansas Supreme Court upholding a retaliatory tax *identical* to the California tax challenged in this appeal. *Prudential Insurance Co.* v. *Hobbs*, 328 U.S. 822 (1946). Moreover, shortly after *Benjamin* and *Hobbs* were decided, most of the states that had repealed their retaliatory tax statutes following the Court's decision in *South-Eastern Underwriters* reenacted those statutes. The import of *Benjamin* and *Hobbs* thus was unmistakable. Congress had the power under the Commerce Clause to authorize state retaliatory taxation of insurance companies, and it had fully exercised that power. If this exercise is now to be undone, it is for Congress, and not for this Court, to do so.

## II

Appellant's equal protection challenge to retaliatory taxation is as unavailing as its Commerce Clause challenge. Unlike the discriminatory taxes struck down by this Court in the past, retaliatory taxes are not aimed arbitrarily at foreign companies as a group. Nor is their purpose merely to increase state revenues. Rather,

the objective of retaliatory taxes is to obtain reciprocity from other states and thereby to promote uniformity of insurance taxation and the free flow of commerce among the states. As such, these measures are fully consistent with our system of federalism and fully consonant with the requirements of equal protection.

The Equal Protection Clause does not demand of states that their tax systems result in rigid equality of taxation. States are given the widest discretion in fashioning classifications that produce reasonable, workable systems of taxation; a classification will be upheld where any state of facts reasonably may be conceived that will sustain it. The ultimate question is whether the classification chosen bears a reasonable relation to the purpose of the law.

California's manifest purpose is to achieve reciprocity. By levying its retaliatory tax on companies from states with high or discriminatory insurance taxes, California seeks to discourage the imposition of such taxes on its own domestic insurers. The retaliatory taxes in effect in 47 states have kept the gross premiums tax rates in most states between 2 and 2.5 percent. Without retaliation, the property and casualty insurance industry believes these rates would go much higher, and the variations among them would multiply, thereby impeding interstate commerce.

Here, too, Congress has acted in a manner that demonstrates the validity of retaliatory taxation. The U.S. Internal Revenue Code contains five retaliatory tax measures permitting the President to impose a higher tax on aliens and foreign corporations within the United States' jurisdiction based solely on the tax laws of the foreigners' home countries. Congress has thus acted with the same purpose—to promote reciprocity—and the same means—imposition of a higher tax on citizens of the offending jurisdiction—as California and her sister states. Evidently, Congress considered such measures appropriate and rational. Furthermore, many other

forms of state regulation, licensing and taxation depend on similar classifications of noncitizens, and would be undermined by invalidation of California's tax.

Insurance retaliatory tax measures are thus not arbitrary, or irrational, or lacking in any conceivable basis in fact. On the contrary, they are workable and effective, contributing significantly to an integrated system of state insurance taxation that has existed for more than a century. Where Congress and the states have exerted all their power to erect such a system, the Court should be loath to overturn it. No evil here exists that would justify such a far-reaching and destructive judgment.

## ARGUMENT

### I. STATE RETALIATORY TAXES, DESIGNED TO LOWER BARRIERS TO INTERSTATE COMMERCE, WERE CONGRESSIONALLY AUTHORIZED BY THE McCARRAN-FERGUSON ACT AND CONSTITUTIONALLY SUSTAINED BY THIS COURT ONE YEAR LATER

#### A. The McCarran Act Authorized the States to Continue Retaliatory Taxation, Notwithstanding That This Court Had Subjected Insurance to the Commerce Clause for the First Time

While appellant characterizes retaliatory insurance taxes as barriers to interstate commerce,[2] they were in fact adopted by the states, not as protectionist devices, but rather to deter or minimize state taxes which themselves were protectionist and impeded commerce across state lines. During the mid-19th century, intense competition within the insurance industry resulted in unduly low premium rates and this, in turn, led to numerous insurance company insolvencies. To protect

[2] The discussion in this brief is limited to the retaliatory tax issue and does not address the separate credit against premium taxes permitted by California for real estate taxes paid on a principal office.

financially threatened domestic insurers, many states enacted legislation imposing heavier taxes upon competing companies domiciled in other states.

Constitutional challenges to these provisions were almost uniformly unsuccessful. In a line of cases beginning with *Paul* v. *Virginia*, 75 U.S. (8 Wall.) 168 (1868), the Court held that insurance was not interstate commerce within the meaning of the Commerce Clause, and thus was governed solely by local law.[3]

As a consequence of these and similar decisions,[4] many states concluded that their only effective remedy against protectionist state barriers was retaliation. By 1944, approximately 40 states had enacted retaliatory taxes like the one presently in force in California. Pyle, *The Metamorphic Retaliatory Tax Law (What Lies Ahead?)*, 23 Ass'n of Life Insurance Counsel Proc. 857, 897 (1972) (hereinafter "Pyle"); Note, *Congressional Consent to Discriminatory State Legislation*, 45 Colum. L. Rev. 927, 930 n.15 (1945).

In 1944, the entire relationship between the states and the federal government in the area of insurance regulation and taxation was transformed by the decision in *United States* v. *South-Eastern Underwriters Association*, 322 U.S. 533 (1944) ("*SEUA*"). By holding that "insurance transactions were subject to federal regulation under the Commerce Clause," *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 458 (1969), *SEUA* effectively overruled the *Paul* v. *Virginia* line of cases.

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[3] *See also* Hooper v. California, 155 U.S. 648 (1895); Noble v. Mitchell, 164 U.S. 367 (1896); New York Life Ins. Co. v. Cravens, 178 U.S. 389 (1900); New York Life Ins. Co. v. Deer Lodge County, 231 U.S. 495 (1913); Bothwell v. Buckbee, Mears Co., 275 U.S. 274 (1927).

[4] *See, e.g.*, Philadelphia Fire Ass'n v. New York, 119 U.S. 110 (1886) (New York retaliatory tax, comparable to California's present statute, valid under Equal Protection Clause); Paul v. Virginia, *supra* (Privileges and Immunities Clause did not apply to corporate insurer).

The McCarran-Ferguson Act, 59 Stat. 33, 15 U.S.C. §§ 1011-1015 (1976), passed one year after *SEUA*, was the product of Congress' concern "about the inroads the Court's decision [in *SEUA*] might make on the tradition of state regulation of insurance." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 458 (1969). As this Court remarked shortly after the Act's passage, "[o]bviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance." *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408, 429 (1946). This comprehensive Congressional purpose, the statute's plain meaning, its structure, the events leading to its sudden passage, and the legislative debates all lead to the conclusion that the McCarran Act authorized the continuation of retaliatory taxation.

The "starting point in a case involving construction of the McCarran-Ferguson Act . . . is the language of the statute itself." *Group Life & Health Insurance Co.* v. *Royal Drug Co.*, 440 U.S. 205, 210 (1979). That language is unequivocal and unqualified. Congress declared that "the *continued* regulation and *taxation* by the several States of the business of insurance is in the public interest." 15 U.S.C. § 1011 (1976) (emphasis added). To implement this objective, Congress provided that "[t]he business of insurance, and every person engaged therein, shall be subject to *the laws* of the several States which relate to the regulation or *taxation* of such business." 15 U.S.C. § 1012(a) (1976) (emphasis added).[5]

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[5] Congress' intention to encompass all forms of state taxation within the McCarran Act is also reflected in 15 U.S.C. § 1012(b) (1976), which provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede *any law* enacted by *any State* for the purpose of regulating the business of insurance, *or which imposes a fee or tax upon such business*, unless such Act specifically relates to the business of insurance" (emphasis added).

This statutory language, repeatedly focusing on "taxation" and "regulation," does not comport with the Solicitor General's sug-

On its face, this language makes no distinction between the varying forms of state taxation. The Act certainly does not distinguish between "retaliatory" and "non-retaliatory" statutes or approve of all but those taxes alleged to be "discriminatory." If Congress had intended to limit the forms of taxation authorized by the Act, "it is not unreasonable to assume that it would have made this explict." *St. Paul Fire & Marine Insurance Co.* v. *Barry*, 438 U.S. 531, 550 (1978). Appellant thus carries a heavy burden of proof in showing that the plain meaning of the statute is contradicted by its legislative history. *Id.* at 541. Appellant has not and cannot carry this burden.

Early versions of the bills that became the McCarran Act made no mention of taxation. Beginning in mid-1944, however, Congress' predominant concern was that state insurance taxes would be struck down under the Commerce Clause if it failed to act.[6]

This concern was well-founded. Immediately after *SEUA* was handed down, insurers in 24 states brought actions asserting that various forms of insurance taxation discriminated against interstate commerce.[7] At least one of these cases, which reached the Supreme Court in 1946, involved a Kansas retaliatory tax virtually identical to the California statute now under attack.[8] By

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gestion that the primary purpose of the McCarran Act was to grant antitrust immunity to the industry rather than to preserve state tax and regulatory laws. Brief for the United States at 15. Indeed, in Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205, 217-18 (1979), the Court characterized the "primary concern of Congress" as enactment of "legislation that would ensure that the States would continue to have the ability to tax and regulate the business of insurance"; "the applicability of the antitrust laws to the insurance industry" was only a "secondary concern."

[6] *See* 90 Cong. Rec. 6548, 6551, 6554 (1944).

[7] Pyle, *supra*, at 897.

[8] In re Insurance Tax Cases, 160 Kan. 300, 161 P.2d 726 (1945), *aff'd per curiam sub nom.* Prudential Ins. Co. v. Hobbs, 328 U.S. 822 (1946).

late 1944, Congress was aware of these legal challenges. State tax officials had informed the legislators that numerous foreign insurers (like appellant) were refusing to pay their premium taxes or would pay only under protest.[9]

In response to the pleas of state tax authorities, a new bill, which eventually became the McCarran Act, was introduced to authorize the continuation of all existing forms of state insurance taxation.[10] The bill was a modification "of a measure which was originally drafted by the legislative committee of the National Association of Insurance Commissioners," that is, those state officials who had the most direct interest in maintaining the systems of state taxation. 91 Cong. Rec. 483 (1945) (remarks of Sen. O'Mahoney). *See also* 91 Cong. Rec. 1488 (1945) (remarks of Sen. Barkley).

Proponents of the bill constantly exhorted their colleagues to expedite passage due to the overhanging threat of massive defaults in state tax payments: "[T]here is urgent need for an immediate expression of policy by the Congress with respect to the continued regulation of the business of insurance by the respective States. Already many insurance companies have refused, while others have threatened refusal to comply with State tax laws, as well as with other State regulations, on the

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[9] In the words of Representative Hancock, "[u]nder [the *SEUA*] decision insurance, if written by a company in more than one State, is, as a matter of law, interstate commerce today . . . . Therefore the taxes imposed on insurance companies in many States may be regarded as burden on interstate commerce and, therefore, unlawful. As a result, many companies are refusing to pay their insurance taxes . . . . Others are paying taxes under protest . . . ." 91 Cong. Rec. 1087 (1945). *See also* 91 Cong. Rec. 479, 482, 484, 485, 979, 1085 (1945).

[10] The bill was originally introduced by Senators McCarran and Ferguson on December 18, 1944, as an amendment to H.R. 3270, 78th Cong., 2d Sess. (1944). It was reintroduced at the outset of the next session of Congress. S. 340, 79th Cong., 1st Sess. (1945). *See also* H.R. 1973, 79th Cong., 1st Sess. (1945).

ground that . . . such laws may subsequently be held unconstitutional in keeping with the precedent-smashing decision in the *Southeastern Underwriters* case . . . ." S. Rep. No. 20, 79th Cong., 1st Sess. 2 (1945).[11] With other changes not here relevant, the bill was quickly passed by the House on February 23, 1945, and by the Senate on February 27, and was signed by the President on March 9. 91 Cong. Rec. 1396, 1489 (1945); 59 Stat. 34 (1945).

These events amply demonstrate that a principal purpose of the McCarran Act—and the primary reason for the expedited passage of the bill in early 1945, after two years of prolonged debate—was to thwart exactly the type of Commerce Clause challenge to state taxes that this case presents.

The broad purpose underlying the Act confirms this reading of the legislative history. Congress was "extending to the States complete immunity for their State tax laws . . . ." 91 Cong. Rec. 488 (1945) (remarks of Sen. O'Mahoney). Congress "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause to whatever extent this may be done with the force of that power behind it . . . ." *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408, 431 (1946).[12] In light of this comprehensive goal, it would be wrong to attribute to Congress an intention to exclude retaliatory taxes: "Congress must have had full knowledge of the nation-wide existence of state systems of

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[11] *See also* H. Rep. No. 68, 79th Cong., 1st Sess. 2 (1945); H. Rep. No. 143, 79th Cong., 1st Sess. 2 (1945); 91 Cong. Rec. 1089, 1092, 1488 (1945).

[12] The debates are likewise replete with statements that Congress intended to confer on the states the broadest possible discretion: "[T]his bill goes as far as we can in an effort to maintain the rights of the States to tax the insurance business within their respective boundaries." 91 Cong. Rec. 1087 (1945) (remarks of Rep. Hancock).

regulation and taxation; of the fact that they differ greatly in the scope and character of the regulation imposed and of the taxes exacted; and of the further fact that many, if not all, include features which, to some extent, have not been applied generally to other interstate business. Congress could not have been unacquainted with these facts and its purpose was evidently to throw the whole weight of its power behind the state systems, notwithstanding these variations." *Id.* at 430.[13]

Indeed, Congress took pains to dispel the inference that its silence could imply disapproval of state tax laws. The preamble to the Act expressly declares "that *silence* on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of [the business of insurance] by the several States." 15 U.S.C. § 1011 (1976) (emphasis added). *See also* 91 Cong. Rec. 482 (1945) (remarks of Sen. Radcliffe). Moreover, in those few areas where Congress intended to carve out a limited federal role notwithstanding that the states had occupied the field, it explicitly so provided.[14]

Finally, it is clear that the states, which actively participated in the drafting of the McCarran Act, contemporaneously interpreted it as approving retaliatory taxes. After *SEUA*, 13 or 14 states repealed various forms of retaliatory taxes, apparently on the assumption that they

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[13] Congress was also aware of the major pre-*SEUA* decision upholding retaliatory taxes. It cited with approval the *Philadelphia Fire Ass'n* case sustaining the constitutionality of New York's retaliatory tax, which was virtually identical to the California tax here in issue. *See, e.g.*, H. Rep. No. 873, 78th Cong., 1st Sess. 2 (1943); 90 Cong. Rec. 6554 (1944).

[14] Thus, state laws could be "invalidated, impaired or superseded" by Federal legislation only where Congress specifically undertook to regulate insurance in a subsequent enactment. 15 U.S.C. § 1012(b) (1976). Similarly, the federal antitrust laws became applicable to the "business of insurance" even though "regulated by State law" only where conduct amounted to "boycott, coercion, or intimidation." 15 U.S.C. §§ 1012(b), 1013(b) (1976). *See also* 91 Cong. Rec. 1481 (1945) (remarks of Sen. Ferguson).

had been invalidated by that decision.[15] Within a few years after passage of the McCarran Act, however, most of these states had reenacted their statutes.[16] It is thus evident that the states believed the McCarran Act authorized retaliatory taxation and acted on that belief. Substantial weight should be accorded to this contemporaneous construction of the statute by those charged with administration of the laws to which it gave effect.[17]

### B. This Court Has Previously Ruled That the McCarran Act Authorized Retaliatory Taxes and That Congress' Authorization Was Within Its Power Under the Commerce Clause

The precise issue presented here—the McCarran Act's approval of retaliatory insurance taxes—is not a new one. It was considered and decided only one year after passage of the Act.

In *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408 (1946), the Court sustained the constitutionality of a South Carolina gross premiums tax laid on foreign insurers but not on domestic companies. In so doing, the Court rejected the very arguments advanced by appellant herein. The Court directly held that Congress had the power under the Commerce Clause to authorize discriminatory state taxes: The "power of Congress over commerce . . . is not restricted, except as the Constitution expressly provides, by any limitation which forbids it to discriminate against interstate commerce and in favor of local trade . . . ." 328 U.S. at 434.[18] Nor was

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[15] Pelletier, *Insurance Retaliatory Laws*, 39 Notre Dame Law. 243, 249 (1964); Pyle, *supra*, at 897.

[16] Pyle, *supra*, at 897.

[17] *See* Norwegian Nitrogen Products Co. v. United States, 288 U.S. 294, 315 (1933); Udall v. Tallman, 380 U.S. 1, 16 (1965); Zenith Radio Corp. v. United States, 437 U.S. 443, 450 (1978).

[18] The only restriction found to be inherent in the Commerce Clause itself was that Congress could not redefine *intra*state transactions as *inter*state commerce; of course, the status of in-

Congress limited to exercising this power independently, since it may be employed "in conjunction with coordinated action by the states . . . ." *Id.*

On the statutory issue whether the McCarran Act actually authorized discriminatory insurance taxes, the Court found no ambiguity: "[The McCarran Act] necessarily was a determination by Congress that state taxes, which in its silence might be held invalid as discriminatory, do not place on interstate insurance a burden which it is unable generally to bear or should not bear in the competition with local business." 328 U.S. at 431.[19]

Of more direct significance is the Court's summary affirmance, based upon *Benjamin*, of a Kansas Supreme Court decision sustaining the constitutional validity of three insurance taxes, one of them a retaliatory tax. *Prudential Insurance Co.* v. *Hobbs*, 328 U.S. 822 (1946). While appellant and supporting *amici curiae* seek to escape the holding in *Hobbs*,[20] it is plainly apparent that

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surance as interstate commerce had already been decided in *SEUA*. Similarly, both before and after *Benjamin*, the Court consistently has upheld Congressional enactments turning over to the states authority to regulate transactions in interstate commerce even where such regulation would have been invalid had Congress remained silent. *See, e.g.*, Clark Distilling Co. v. Western Md. Ry. Co., 242 U.S. 311 (1917); Kentucky Whip & Collar Co. v. Illinois Central R.R. Co., 299 U.S. 334 (1937); Cloverleaf Butter Co. v. Patterson, 315 U.S. 148, 155 n.4 (1942) (dictum); Southern Pacific Co. v. Arizona, 325 U.S. 761, 769 (1945) (dictum); International Shoe Co. v. Washington, 326 U.S. 310, 315 (1945) (dictum); Panhandle Eastern Pipe Line Co. v. Public Service Comm'n, 332 U.S. 507, 521 (1947) (analogizing Natural Gas Act to McCarran Act in upholding state regulation of natural gas sales); Lewis v. BT Investment Managers, Inc., 100 S. Ct. 2009, 2019-2020 (1980) (dictum).

[19] The Court also noted that South Carolina's tax was "not uncommon among the states," *id.*, just as California's retaliatory tax is typical of those in most other states.

[20] *Hobbs* cannot be read for the proposition that retaliatory taxes are constitutional only when the aggregate tax burden borne by foreign insurers is the same as that borne by domestic insurers,

the Kansas statute was *identical* in concept to that of California. It provided "that when the laws of a state under which the insurance company was incorporated require the payment of greater taxes, etc., from insurance companies of other states than is required by the existing laws of this state, then such company shall pay the taxes, etc., which would be required by a company organized in this state in order to do business in such other state." *In re Insurance Tax Cases*, 160 Kan. 300, 303, 161 P.2d 726, 730 (1945).

In short, there is no principled basis in the McCarran Act's legislative history or in the *Benjamin* and *Hobbs* decisions for differentiating the South Carolina and Kansas taxes from the California tax. Indeed, it would be anomalous to strike down retaliatory taxes as discriminatory while approving the truly discriminatory or burdensome taxes against which retaliation is directed. If the California tax is to be invalidated, it can only be by expressly overruling *Benjamin* and *Hobbs*.

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albeit they are taxed under different mechanisms. In *Benjamin*, the Court deliberately refused to base its holding on this type of factual showing, but instead upheld South Carolina's tax under the assumption that it discriminated on its face. 328 U.S. at 428-29. In any event, an alternative ground for the Kansas court's holding in *Hobbs* was that Congress constitutionally could defer to state retaliatory taxation and in fact had chosen to do so through the McCarran Act. This, of course, was the same reasoning employed by this Court in *Benjamin* and it is therefore logical to conclude that *Hobbs* was decided on this same ground.

Additionally, while the Court in *Benjamin* expressed "no opinion concerning the validity" of state provisions "not substantially identical with those of the South Carolina statute," 328 U.S. at 432 n.40, this caveat cannot be extended to nullify *Hobbs*. Obviously, by the very fact of deciding *Hobbs*, the Court *did* reach an opinion on Kansas' retaliatory tax. If it had felt that the *Benjamin* rationale did not apply to retaliatory taxes, it could have affirmed as to Kansas' general premiums tax and reversed or remanded as to the other two Kansas taxes, or heard argument on those taxes. It did neither, but affirmed outright and summarily.

### C. Because of the States' and Industry's Substantial Reliance, This Court's Past Decisions Should Not Now Be Overruled and Long-Established Systems of Taxation Upset

This case well illustrates the policies underlying the doctrine of *stare decisis*. For over 34 years, the states have relied on *Benjamin* and *Hobbs* as establishing the validity of retaliatory taxes. The great majority of the states which had repealed retaliatory taxes following *SEUA* reenacted them following passage of the McCarran Act and the Court's decision in *Benjamin*. At present, all but three states have adopted some form of retaliatory taxation, most of them years ago.

To overturn these taxes now would penalize both the states and the industry for their justifiable reliance on the decisions of the highest court in the land.[21] Long-established systems of taxation would be upset, with serious financial consequences involving potentially enormous refunds and the attendant burdens of resolving complicated and stale claims. Reversal undoubtedly would precipitate a wave of litigation similar to that which struck the courts after *SEUA*. Even more than in 1946, the circumstances call for affirmation of state retaliatory taxes.

## II. STATE RETALIATORY TAXATION OF INSURANCE COMPANIES IS RATIONAL, NOT ARBITRARY, AND THUS DOES NOT VIOLATE THE EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT

### A. The Equal Protection Standard for Measuring a State Tax Classification Is Whether Any State of Facts Reasonably May Be Conceived That Would Justify the Distinction Drawn by the Statute

The Equal Protection Clause of the Fourteenth Amendment has never been construed by this Court as

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[21] *See* Flood v. Kuhn, 407 U.S. 258 (1972).

imposing an "iron rule of equality" from which state tax measures may not depart. *See Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522, 526 (1959); *Carmichael* v. *Southern Coal & Coke Co.*, 301 U.S. 495, 509 (1937). On the contrary, the Court has always accorded the states, as sovereign bodies, the widest discretion: "Where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Lehnhausen* v. *Lake Shore Auto Parts Co.*, 410 U.S. 356, 359 (1973) (footnote omitted).

In view of the states' broad latitude, "a classification, though discriminatory, is not arbitrary nor violative of the Equal Protection Clause of the Fourteenth Amendment if any state of facts reasonably can be conceived that would sustain it." *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522, 528 (1959).[22] Moreover, the burden is on the party challenging the state's classification "to negative every conceivable basis which might support it." *Madden* v. *Kentucky*, 309 U.S. 83, 88 (1940).[23]

This rule is not altered simply because the statutory classification results in some unequal treatment between foreign and domestic corporations. The "ultimate test of validity is not whether foreign corporations differ from domestic, but whether the differences between them are pertinent to the subject with respect to which the classification is made." *Metropolitan Casualty Insurance Co.* v. *Brownell*, 294 U.S. 580, 583 (1935). Thus,

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[22] *Accord*, Dandridge v. Williams, 397 U.S. 471, 485 (1970); Madden v. Kentucky, 309 U.S. 83, 88 (1940); Metropolitan Casualty Ins. Co. v. Brownell, 294 U.S. 580, 584 (1935); Lindsley v. Natural Carbonic Gas Co., 220 U.S. 61, 78 (1911); *cf.* Vance v. Bradley, 440 U.S. 93, 111 (1979) ("conceivable basis" test applied under equal protection component of Fifth Amendment Due Process Clause); United States v. Maryland Savings-Share Ins. Corp., 400 U.S. 4, 6 (1970) (same).

[23] *Accord*, Vance v. Bradley, 440 U.S. 93, 111 (1979); Lindsley v. Natural Carbonic Gas Co., 220 U.S. 61, 78-79 (1911).

the Court has regularly upheld state statutes differentiating between foreign and domestic companies where the distinction is rationally related to a valid state purpose.[24]

Conversely, in the tax area, decisions condemning unequal state taxation of foreign and domestic corporations have focused on the lack of a rational justification for the particular taxes imposed. *See Hanover Fire Insurance Co.* v. *Harding*, 272 U.S. 494, 508 (1926). Where, for example, the only justification offered is simply the state's desire to obtain more *ad valorem* tax revenue from out-of-state corporations than from its own domestic ones, the Court has not hesitated to strike down such measures.[25]

This case stands on an entirely different footing. The purpose of California's retaliatory tax is not to raise revenue, but to obtain reciprocal treatment.[26] California does not classify foreign insurers as a unitary group, automatically subject to a higher level of taxation than domestic insurers.[27] Rather, out-of-state companies are

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[24] *See, e.g.*, Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 814 (1976); Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 528-29 (1959); Metropolitan Casualty Ins. Co. v. Brownell, 294 U.S. 580 (1935).

[25] *See, e.g.*, WHYY, Inc. v. Glassboro, 393 U.S. 117, 120 (1968); Wheeling Steel Corp. v. Glander, 337 U.S. 562, 572 (1949).

[26] Appellant asserts that reciprocity is not a legitimate state purpose, citing Wheeling Steel Corp. v. Glander, 337 U.S. 562 (1949). That case, however, did not involve reciprocity as that term is properly understood. Ohio imposed its tax on foreign corporations regardless of whether the foreign corporation's home state taxed Ohio corporations in like manner. *See id.* at 573-74. Plainly, Ohio had no purpose to promote commerce or obtain desirable treatment for its corporations doing business elsewhere. Its sole interest was in obtaining greater revenues from non-Ohio companies.

[27] Thus, the Court is not faced with the issue of outright discrimination between foreign and domestic corporations where the taxing state has no intention to seek reciprocity from the foreign corporation's home state. Distinctions dealing with permissible conditions on foreign companies' access to the state are therefore

categorized on the basis of the taxing policies of their home jurisdictions. As a result, the proper test for evaluating California's retaliatory tax is not whether a foreign insurer may in some instances be required to pay a higher tax than a domestic company, but whether California's purpose is legitimate and whether any state of facts may reasonably be conceived to sustain its classification.

### B. State Retaliatory Taxation of Insurance Companies Is Based on the Entirely Rational Premise That This System Tends to Promote Uniformity, Minimize Burdens on the Insurance Business, and Foster Interstate Commerce in Insurance

This Court has never "assume[d] that state legislative enactments were adopted arbitrarily or without good reason to further some legitimate policy of the State." *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522, 528 (1959). In light of the adoption of retaliatory taxes in 47 states [28] and the nearly universal state court

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irrelevant, including such factors as whether California's retaliatory tax is a "privilege" tax, whether appellant holds an "unequivocal" license to do business in the state, or whether this tax generally would fall within the rule enunciated in Lincoln National Life Ins. Co. v. Read, 325 U.S. 673 (1945). California's retaliatory tax is valid whether or not a statute imposing a higher tax on all foreign insurers as a group would be permissible under the Equal Protection Clause.

Equally irrelevant is the timing of appellant's entry into the state. A state may change its tax laws relating to foreign corporations at any time, so long as such taxes do not violate the Constitution. *See* Cheney Bros. Co. v. Massachusetts, 246 U.S. 147, 157 (1918).

[28] The retaliatory tax statutes of most states, including California, are sufficiently broad to apply both (1) where the foreign state discriminates between in-state and out-of-state companies and (2) where the foreign state simply imposes on both in-state and out-of-state companies a higher tax than the retaliating state. Even if the Court were to rule that retaliatory taxes are unconstitutional where they apply merely because of a foreign state's higher tax burden, the Court should not strike down these statutes on their

approval of retaliatory measures as constitutionally sound,[29] the Court should accord this tax system a strong presumption of validity, particularly since Congress, in the McCarran Act, threw the full weight of its power behind state insurance taxes.[30]

The purpose of state retaliatory taxation is to promote uniformity in taxation of the national insurance business, and thereby to promote interstate commerce in insurance to the benefit of domestic insurers, the state's economy and its citizens. Since the McCarran Act has removed many of the Commerce Clause restrictions that might otherwise apply to state insurance taxation, the states must necessarily use such tools as are at their disposal to prevent burdensome taxation of domestic insurers when they go forth to do business in other states. Retaliatory tax laws are intended to drive the rates of gross premium taxation toward a common level such that no state imposes a disproportionate burden on the revenues of this essentially interstate business. Considering this purpose, the classification by California and her sister states is not overly broad. The retaliatory tax is levied only where another state imposes a higher tax, and only in an amount equal to the difference.

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face, but should reserve the issue whether retaliatory provisions may be constitutionally applied where a foreign state is found to discriminate against out-of-state insurers.

[29] *See, e.g.*, Commonwealth v. Fireman's Fund Ins. Co., 369 Pa. 560, 87 A.2d 255 (1952); Clay v. Dixie Fire Ins. Co., 168 Ky. 315, 181 S.W. 1123 (1916); Phoenix Ins. Co. v. Welch, 29 Kan. 672 (1883).

[30] While Congress does not, of course, have the authority to transgress constitutional limitations, the Court has taken into account Congressional ideas of policy, especially where "Congress has posited a regime of state regulation on the continuing validity of specific prior decisions." State Board of Ins. v. Todd Shipyards Corp., 370 U.S. 451, 457 (1962). *See also* Philadelphia Fire Ass'n v. New York, 119 U.S. 110 (1886) (cited in McCarran Act legislative history).

The Court need not agree that this is the best, or the most effective, means of accomplishing the states' goals. Judgments of social and economic policy have long been left to the legislatures, not the courts.[31] Nor need the Court find that the retaliatory tax system has accomplished its goals perfectly in order to uphold its constitutionality. A reasonable classification does not offend against the Equal Protection Clause merely because it does not function with "mathematical nicety." *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U.S. 61, 78 (1911). The issue is whether state legislators could rationally have believed that such a tax system would accomplish its legitimate goals.

As the chart appearing in Appendix B demonstrates, retaliatory taxation has proven to be effective. Thirty-six states and the District of Columbia impose gross premiums taxes of between 2 and 2.5 percent on out-of-state property and casualty insurers. Approximately half the states have settled on 2 percent as the appropriate level of taxation. Of the ten states imposing a premiums tax greater than 2.5 percent, five offer foreign companies a reduction in the rate if they make investments in the state.

While other explanations can be offered for this substantial degree of uniformity, the property and casualty insurance industry, which pays a substantial portion of the retaliatory taxes imposed, believes that this uniformity is largely attributable to retaliatory taxation and that, in the absence of retaliation, disparities in tax rates would increase dramatically. California's own courts similarly have expressed the view that the purpose of retaliatory taxation has been achieved, observing that the effort "to discourage any state from imposing discriminatory taxes or other burdens upon out-of-state companies . . . seems to have been largely successful."

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[31] *See, e.g.*, Dandridge v. Williams, 397 U.S. 471, 484-85 (1970); Williamson v. Lee Optical Co., 348 U.S. 483, 487-88 (1955).

*Atlantic Insurance Co.* v. *State Board of Equalization*, 255 Cal. App. 2d 1, 62 Cal. Rptr. 784 (Ct. App. 1967), *appeal dismissed and cert. denied*, 390 U.S. 529 (1968). And only a few months ago, the District of Columbia Department of Finance and Revenue confirmed that "the potential retaliation tax payable to other states has been an effective mechanism for restraining the premium tax rate." District of Columbia Dept. of Finance and Rev., *Insurance Tax Alternatives* 3 (May 1, 1980).[32]

### C. Congress Has Enacted Retaliatory Tax Measures Classifying Aliens and Foreign Corporations on the Basis of their Home Countries' Laws, Thus Demonstrating That California's Similar Tax is Not Irrational

The U.S. Internal Revenue Code contains no fewer than five retaliatory tax measures closely similar to California's. Each of the five provides that the President may, by proclamation, impose a retaliatory tax on an alien or foreign corporation based on the taxes imposed by the foreign taxpayer's home country. While slight differences exist among them, these provisions collectively employ the same type of classifications and have the same purpose as the California retaliatory tax. They illustrate Congress' judgment that a retaliatory tax may be an effective means of achieving some measure of protection against excessive or unfair taxation. The text of these five measures appears in Appendix C.

Section 891 authorizes the President to double the tax rate (up to a maximum of 80 per cent of gross income) on citizens and corporations of any foreign country subjecting American citizens or corporations to discriminatory or extraterritorial taxes. This provision not only permits higher United States taxes on citizens and corporations of one country than on similarly situated citizens and corporations of another country—based solely

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[32] We have lodged a copy of this document with the Clerk of the Court.

on the laws of the respective countries—but it also authorizes higher taxes on foreigners present in the United States than those imposed on United States citizens. The potential effects of this measure thus parallel those of California's statute.

Section 896 encompasses two measures added to the Code by the Foreign Investors Tax Act of 1966 ("FITA"), Pub. L. No. 89-809, § 105(b), 80 Stat. 1563. Section 896(a) empowers the President to deny FITA tax benefits to residents or corporations of any foreign country subjecting United States citizens or corporations to more burdensome taxes on income received from sources within that country than the United States would impose on United States-source income of that country's residents or corporations. This provision, like California's retaliatory tax, does not require for its application that the foreign jurisdiction discriminate against citizens of the retaliating jurisdiction; a higher level of taxation alone triggers retaliation. Rather than merely duplicating the other country's more burdensome taxes, however, section 896(a) authorizes the President to deny all tax advantages otherwise available under the FITA, thus resulting in retaliation that may be harsher, less harsh, or equivalent to the additional tax burden imposed by the other country.[33]

Section 896(b) was enacted primarily to remedy a perceived deficiency in the operation of section 891. Whereas section 891 authorizes only a doubling of taxes on foreigners, section 896(b) gives the President "authority to counteract discrimination by effecting substantially the same tax on the persons of the discriminating country" as that country imposes on Americans. S. Rep.

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[33] The legislative history shows that this measure was designed to strengthen the government's hand in dealing with "any country which imposes more burdensome taxes on U.S. citizens and corporations than the United States does on nonresident aliens and foreign corporations." H. Rep. No. 1450, 89th Cong., 2d Sess. 34-35 (1966).

No. 1707, 89th Cong., 2d Sess. 42 (1966). This is, of course, the same remedy prescribed by California.

Section 901(c) originated as section 222(a)(3) of the Revenue Act of 1918, Pub. L. No. 254, 40 Stat. 1057, and is thus the oldest of the federal retaliatory measures. In its present form, section 901(c) empowers the President to deny resident aliens the benefits of the tax credit for income, war profits and excess-profits taxes paid to a foreign country unless the alien's home country provides a like credit to American citizens. The objective is to encourage foreign countries to relieve American taxpayers of a double tax burden on foreign income by offering relief from United States taxes to citizens of reciprocating countries.[34] The last provision, section 2014(h), was patterned after section 901(c) and its predecessors. It authorizes denial of the estate tax credit to citizens of foreign countries that deny United States citizens a credit for estate taxes paid in the United States or other countries.

For equal protection purposes, these measures are indistinguishable from California's retaliatory insurance tax. Embodied in the Due Process Clause of the Fifth Amendment is an equal protection principle identical to that applied to the states by the Fourteenth Amendment.[35] Moreover, it has long been settled that the Fifth Amendment, like the Fourteenth, protects foreign nationals who are within the jurisdiction of the United States.[36] A Congressional enactment that failed to satisfy

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[34] *See* Bowring v. Comm'r of Internal Revenue, 27 B.T.A. 449, 452, 456 (1932); H. Rep. No. 767, 65th Cong., 2d Sess. 11 (1918). *See also* Burnet v. Chicago Portrait Co., 285 U.S. 1, 8 n.6 (1932).

[35] Buckley v. Valeo, 424 U.S. 1, 93 (1976); Weinberger v. Weisenfeld, 420 U.S. 636, 638 n.2 (1975); *cf.* Bolling v. Sharpe, 347 U.S. 497, 499 (1954) (equal protection concept first applied to Congressional enactment).

[36] Mathews v. Diaz, 426 U.S. 67, 77 (1976); Wong Yang Sung v. McGrath, 339 U.S. 33, 49-51 (1950); Wong Wing v. United States, 163 U.S. 228, 238 (1896).

the conceivable basis test of traditional equal protection analysis thus would not be valid simply because it applied only to aliens.[37]

These federal retaliatory tax measures are justified by no federal interest distinct from the interest asserted by California in this case. In both instances, the jurisdiction imposing retaliation is seeking to promote free trade outside its borders by inducing other jurisdictions to remove burdensome restrictions on domestic citizens or corporations doing business there. If this is a permissible purpose for Congress to entertain, and retaliation a reasonable means to achieve it, why should the same purpose and the same means be denied to the 47 states having retaliatory laws similar to those of the United States?

### D. The Constitutionality of Numerous Other State Laws Would Be Called Into Question If This Court Were to Strike Down Retaliatory Taxes

State retaliatory taxes imposed on insurance companies are not the only state laws distinguishing among noncitizens based upon the laws existing in their home states. In fact, the retaliatory/reciprocal approach is widely used.[38]

A number of states, for example, have statutes authorizing retaliation against owners of motor vehicles registered in states imposing more burdensome taxes and fees on vehicles of the retaliating state.[39] Ten states have stat-

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[37] *See* Hampton v. Mow Sun Wong, 426 U.S. 88, 101, 103 (1976).

[38] The varying forms of these statutes should not be assumed to distinguish them for constitutional purposes. Whether the retaliating government imposes a higher tax to match the other jurisdiction's higher tax, or denies a tax credit otherwise available because the foreign state makes no such credit available, the result is the same insofar as the taxpayer is concerned: a greater tax is collected based solely on the laws of the taxpayer's home state. Labeling such systems "reciprocal" or "retaliatory" in no way affects their constitutionality.

[39] Typical of these is New Jersey's Counterpart Fee Act, N.J. Rev. Stat. § 39:3-6 (1973), which was upheld against equal protec-

utes or court rules admitting otherwise qualified attorneys to practice without a bar examination if the attorney is licensed in a state granting the same privilege.[40] Such laws have been upheld under the Equal Protection Clause as rationally related to the state's goal of achieving reciprocal treatment of its attorneys in other states.[41]

Finally, many state death and income tax laws deny to nonresidents the benefits of certain credits, deductions or exemptions otherwise available solely because the nonresidents' home states do not make like benefits available to the taxing state's citizens.[42] That the states could deny such credits to nonresidents altogether has no bearing on the constitutionality of these laws. Even where the government is free to withhold a privilege at will, it may not deny the privilege on an unconstitutional basis.[43] Reciprocal availability of the credit results in

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tion, due process, and Commerce Clause challenges in B&L Motor Freight, Inc. v. Heymann, 120 N.J. Super. 270, 293 A.2d 711 (N.J. Ch. 1972), *aff'd*, 125 N.J. Super. 372, 311 A.2d 184 (App. Div. 1973). *See also* Ind. Code Ann. § 9-7-8-1 (Burns 1980); Mich. Comp. Laws Ann. § 3.168 (1967); Neb. Rev. Stat. § 60-305.02 (1978); N.H. Rev. Stat. Ann. § 260:40 (1978).

[40] *See, e.g.*, Miss. Code Ann. § 73-3-25 (1975); Rule 1A:1, Rules of the Supreme Court of Va. (1977). *See generally* Rules for Admission to the Bar in the United States and Territories (West 1979).

[41] *See, e.g.*, Hawkins v. Moss, 503 F.2d 1171, 1177 (4th Cir. 1974), *cert. denied*, 420 U.S. 928 (1975); Goldsmith v. Pringle, 399 F. Supp. 620, 623-25 (D. Colo. 1975) (three-judge court); Shenfield v. Prather, 387 F. Supp. 676, 689 (N.D. Miss. 1974) (three-judge court); *cf.* In re Griffiths, 413 U.S. 717, 733 (1973) (Burger, C.J., dissenting) (Equal Protection Clause would not foreclose state from admitting to practice only those nationals of countries admitting Americans to practice).

[42] *See, e.g.*, Md. Rev. & Tax. Code Ann. § 291(a) (1975) (income tax credit); W. Va. Code § 11-21-40 (1974) (same).

[43] *See* Perry v. Sindermann, 408 U.S. 593, 597 (1972). *See also* Note, *Unconstitutional Conditions*, 73 Harv. L. Rev. 1595 (1960); Van Alstyne, *The Demise of the Right-Privilege Distinction in Constitutional Law*, 81 Harv. L. Rev. 1439 (1968).

discrimination *between nonresidents*, which cannot occur where the credit is denied outright. For equal protection purposes, the critical question this raises is the same as the issue in this case, namely, whether the classification of noncitizens on the basis of the laws of their home states serves a rational purpose.[44] Distinguishing among noncitizens in this way is constitutional on the same basis as California's retaliatory insurance tax: because the state's purpose—to encourage reciprocity—is a valid and rational one.[45]

### E. Equal Protection Does Not Compel Judicial Intrusion Into an Area Where Both Congress and the States Have Validly Exercised Their Legislative Judgment

While we believe that retaliatory taxation has worked remarkably well, this Court need not find that it has been a perfect instrument in order to sustain it. The Equal Protection Clause does not demand perfection. It requires only that the states exercise their taxing power in a manner not arbitrary or without any conceivable basis in fact. While reasonable men might differ on the wisdom and efficacy of retaliatory tax statutes, by no means can it be said that these measures are irrational.

On the contrary, logic, long experience and empirical evidence confirm the validity of the states' legislative judgment that retaliatory taxes are generally workable

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[44] The same is true of death tax exemptions for gifts to foreign charities, granted in 24 states only where the other state reciprocates. *See* 1 Estate Planning: Inheritance and Transfer Tax (P-H) ¶ 854 (1980).

[45] Of course, if the Court upholds California's retaliatory tax on insurance corporations, the states would not necessarily have similarly broad discretion to differentiate among natural persons who are nonresidents. The Privileges and Immunities Clause, U.S. Const. art. IV, § 2, cl. 1, imposes an independent constraint on state actions affecting individuals that does not exist for corporations. *See* Austin v. New Hampshire, 420 U.S. 656, 667 (1975) (state retaliation against individuals impermissible).

and effective. It is for this reason that the vast majority of property and casualty insurers—the supposed "victims" of these "discriminatory" measures—support them.

Far from representing an effort by states to discriminate against interstate commerce, retaliatory statutes are essentially equalizing laws. Their aim is to strike a balance between the states' legitimate needs for revenue, and a uniform level of insurance taxation that will not prove stifling to commerce. Retaliatory taxes thus not only meet the requirements of the Equal Protection Clause, but also comport fully with the free trade principles underlying the Commerce Clause and the policy of deference to state regulation embodied in the McCarran Act. In sum, the question here is ultimately one of policy, and its resolution is best left to legislative judgment, free from judicial intrusion.

Insurance retaliatory taxes represent the coordinated action of Congress and the states. They are "therefore reinforced by the exercise of all the power of government residing in our scheme." *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408, 436 (1946). Where Congress and the states have so combined their powers to enact a coordinated system of taxation, the Court should refrain from interfering absent an evil so "clear and gross" that it plainly exceeds the outermost limits of the Constitution. *Id.* Appellant has utterly failed to demonstrate any such evil.

## CONCLUSION

The judgment of the Court of Appeal of California should be affirmed.

Respectfully submitted,

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# Appendices

## APPENDIX A

## OHIO INSURANCE TAX PROVISIONS

*Domestic Insurance Companies*

5725.18. Annual franchise tax on the privilege of being an insurance company

An annual franchise tax on the privilege of being an insurance company is hereby levied, measured by the smaller of the following bases as applied to a domestic insurance company:

(A) The capital and surplus of a domestic insurance company having capital divided into shares, or the surplus of a domestic insurance company not having capital divided into shares, at the value thereof reported by the company in its annual statement for the preceding year filed with and approved by the superintendent of insurance setting forth the admitted and nonadmitted assets and the liabilities of the company, including in such liabilities:

(1) The reserve and unearned premium liabilities computed as provided by law, the same being the amount of debts of an insurance company because of its outstanding policies in gross;

(2) Amounts set apart for the payment of dividends to policyholders, and all actual liabilities set forth in the annual statement;

(B) Eight and one-third times the gross amount of premiums received by any such domestic insurance company from policies covering risks within this state during the preceding calendar year, after making the deductions prescribed by section 5729.03 of the Revised Code for foreign insurance companies. The objects of such

tax are those declared in section 5725.24 of the Revised Code, to which only the same shall be applied.

5725.19. Rate of franchise tax on domestic insurance companies

In the month of June, annually, the auditor of state shall charge for collection from each domestic insurance company a franchise tax of three-tenths of one percent of the amount determined by the superintendent of insurance pursuant to section 5725.18 of the Revised Code and certified to the auditor of state. In no case shall such tax be less than twenty-five dollars.

*Foreign Insurance Companies*

5729.03. Computation and collection of tax

If the superintendent of insurance finds the annual statement required by section 5729.02 of the Revised Code to be correct, he shall compute an amount of two and one-half percent of the balance of such gross amount, after deducting such return premiums and considerations received for reinsurance, and charge such amount to such company as a tax upon the business done by it in this state for the period covered by such annual statement; provided, that any insurance policies which were not issued in violation of Title XXXIX of the Revised Code and which were issued prior to April 15, 1967, by a life insurance company organized and operated without profit to any private shareholder or individual, exclusively for the purpose of aiding educational or scientific institutions organized and operated without profit to any private shareholder or individual, are not subject to the tax imposed by this section. All taxes collected pursuant to this section shall be credited to the general revenue fund.

# APPENDIX B

**Gross Premiums Tax Rates Applicable**

**to Out-of-State Property and Casualty Insurance Companies ***

| Less than 2% | 2% | 2.25 - 2.35% | 2.5% | 2.75% | 3% | More than 3% |
|---|---|---|---|---|---|---|
| Delaware (1.75%) | Arizona | California (2.35%) | Arkansas | Montana (b) | Alaska | Alabama (a) (b) (4%) |
| Louisiana (b) (1.85%) | Connecticut | Colorado (a) (2.25%) | New Mexico (b) | Virginia | Idaho | Hawaii (4.2824%) |
| New York (1.2%) | District of Columbia | Georgia (b) (2.25%) | North Carolina | | Mississippi | Oklahoma (b) (4%) |
| Wisconsin (c) (.375%) | Florida (a) | Massachusetts (2.28%) | North Dakota | | West Virginia (b) | Texas (b) (3.85%) |
| | Illinois | Oregon (2.25%) | Ohio | | | |
| | Indiana | Utah (2.25%) | South Dakota (a) | | | |
| | Iowa | | Wyoming (b) | | | |
| | Kansas | | | | | |
| | Kentucky | | | | | |
| | Maine | | | | | |
| | Maryland | | | | | |
| | Michigan (d) | | | | | |
| | Minnesota | | | | | |
| | Missouri | | | | | |
| | Nebraska | | | | | |
| | Nevada (a) | | | | | |
| | New Hampshire | | | | | |
| | New Jersey | | | | | |
| | Pennsylvania | | | | | |
| | Rhode Island | | | | | |
| | South Carolina (b) | | | | | |
| | Tennessee | | | | | |
| | Vermont | | | | | |
| | Washington | | | | | |

(a) Rate or tax reduced if regional or principal home office maintained in state.

(b) Rate or tax reduced for prescribed percentages of investments in state.

(c) Wisconsin charges out-of-state insurers the same rates as their home states charge foreign insurers, subject to a minimum of 3/8 of 1%.

(d) Michigan imposes a 3% tax on fire, marine and strictly auto insurance.

* This chart is based on the statutes of the fifty states and the District of Columbia as compiled in American Insurance Association, State Taxation Manual (December 1980).

## APPENDIX C

## FEDERAL RETALIATORY TAX PROVISIONS CONTAINED IN THE U.S. INTERNAL REVENUE CODE

### SECTION 891

§ 891. Doubling of rates of tax on citizens and corporations of certain foreign countries.

Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 802, 821, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by such sections as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer (computed with regard to the deductions allowable under section 151 and under part VIII of subchapter B). Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.

## SECTION 896(a)

§ 896. Adjustment of tax on nationals, residents, and corporations of certain foreign countries.

(a) Imposition of more burdensome taxes by foreign country

Whenever the President finds that—

(1) under the laws of any foreign country, considering the tax system of such foreign country, citizens of the United States not residents of such foreign country or domestic corporations are being subjected to more burdensome taxes, on any item of income received by such citizens or corporations from sources within such foreign country, than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country,

(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such taxes so that they are no more burdensome than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country, and

(3) it is in the public interest to apply pre-1967 tax provisions in accordance with the provisions of this subsection to residents or corporations of such foreign country,

the President shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for taxable years beginning after such proclamation, be determined under this subtitle without regard to amendments made to this subchapter and chapter 3 on or after the date of enactment of this section.

## SECTION 896(b)

(b) Imposition of discriminatory taxes by foreign country

Whenever the President finds that—

(1) under the laws of any foreign country, citizens of the United States or domestic corporations (or any class of such citizens or corporations) are, with respect to any item of income, being subjected to a higher effective rate of tax than are nationals, residents, or corporations of such foreign country (or a similar class of such nationals, residents, or corporations) under similar circumstances;

(2) such foreign country, when requested by the United States to do so, has not acted to eliminate such higher effective rate of tax; and

(3) it is in the public interest to adjust, in accordance with the provisions of this subsection, the effective rate of tax imposed by this subtitle on similar income of nationals, residents, or corporations of such foreign country (or such similar class of such nationals, residents, or corporations),

the President shall proclaim that the tax on similar income of nationals, residents, or corporations of such foreign country (or such similar class of such nationals, residents, or corporations) shall, for taxable years beginning after such proclamation, be adjusted so as to cause the effective rate of tax imposed by this subtitle on such similar income to be substantially equal to the effective rate of tax imposed by such foreign country on such item of income of citizens of the United States or domestic corporations (or such class of citizens or corporations). In implementing a proclamation made under this subsection, the effective rate of tax imposed by this subtitle on an item of income may be adjusted by the disallowance, in whole or in part, of any

deduction, credit, or exemption which would otherwise be allowed with respect to that item of income or by increasing the rate of tax otherwise applicable to that item of income.

SECTION 901(c)

(c) Similar credit required for certain alien residents

Whenever the President finds that—

(1) a foreign country, in imposing income, war profits, and excess profits taxes, does not allow to citizens of the United States residing in such foreign country a credit for any such taxes paid or accrued to the United States or any foreign country, as the case may be, similar to the credit allowed under subsection (b)(3),

(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit to citizens of the United States residing in such foreign country, and

(3) it is in the public interest to allow the credit under subsection (b)(3) to citizens or subjects of such foreign country only if it allows such a similar credit to citizens of the United States residing in such foreign country,

the President shall proclaim that, for taxable years beginning while the proclamation remains in effect, the credit under subsection (b)(3) shall be allowed to citizens or subjects of such foreign country only if such foreign country, in imposing income, war profits, and excess profits taxes, allows to citizens of the United States residing in such foreign country such a similar credit.

SECTION 2014(h)

(h) Similar credit required for certain alien residents

Whenever the President finds that—

(1) a foreign country, in imposing estate, inheritance, legacy, or succession taxes, does not allow to citizens of

the United States resident in such foreign country at the time of death a credit similar to the credit allowed under subsection (a),

(2) such foreign country, when requested by the United States to do so has not acted to provide such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death, and

(3) it is in the public interest to allow the credit under subsection (a) in the case of citizens or subjects of such foreign country only if it allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death,

the President shall proclaim that, in the case of citizens or subjects of such foreign country dying while the proclamation remains in effect, the credit under subsection (a) shall be allowed only if such foreign country allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

No. 79-1423

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

*Appellant*,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

*Appellee*.

**ON APPEAL FROM THE COURT OF APPEAL SECOND APPELLATE DISTRICT, STATE OF CALIFORNIA**

# BRIEF FOR STATES OF ARIZONA AND WISCONSIN AS AMICI CURIAE


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# BRIEF FOR STATES OF ARIZONA AND WISCONSIN AS AMICI CURIAE

---

The Attorneys General of the States of Arizona and Wisconsin submit this brief in support of the State of California's position herein pursuant to United States Supreme Court Rule 36.4.

## Jurisdiction

Jurisdiction was noted by this Court on October 5, 1980.

## Question Presented

May California levy a retaliatory tax in excess of the normal tax against companies domiciled elsewhere, if the state of their domicile taxes insurance companies at a rate higher than does California?

## Interest of the Amici Curiae

The States of Arizona and Wisconsin are vitally interested in this matter because the California retaliatory tax at issue here closely resembles a similar tax imposed by both the States of Arizona and Wisconsin.

Appellant, The Western and Southern Life Insurance Company, appeals from a decision of the Court of Appeal of the State of California upholding the California retaliatory tax. If this Court reverses the decision of the California Court of Appeal, the validity of retaliatory taxes will be thrown into question, and Arizona's and Wisconsin's ability to successfully defend challenges in their courts to the constitutionality of retaliatory taxes will be seriously hampered. The California Court of Appeal also upheld the principal office deduction under the California gross premium tax. Neither Arizona nor Wisconsin have a similar provision in their gross premium tax. Therefore, the issue of the principal office deduction will not be discussed in this brief.

The pertinent portions of the Arizona and Wisconsin retaliatory taxes applicable to life insurance companies are virtually identical to the California tax which is before this

Court. The relevant portions of the Arizona and Wisconsin statutes are set forth in full in Appendix "A", *infra*.

Under Arizona Revised Statutes §20-230(A) the Arizona retaliatory tax is imposed upon an out-of-state life insurance company doing business in Arizona if the state of domicile of the out-of-state company would impose higher taxes upon a similar hypothetical Arizona life insurance company doing business in that state. The tax is triggered by higher rates and more inclusive tax bases in other states rather than by discriminatory tax treatment of Arizona insurers doing business in such states. Insofar as the Wisconsin retaliatory tax (Wis. Stat. §§76.35, 76.36) is concerned, the effect and operation of its provisions are, in all material respects, the same as those of California and Arizona.

Finally, while the *amici curiae* firmly believe that this Court should affirm the lower court decision herein, due to the prior good faith reliance by the *amici curiae* states upon and interpretation of various decisions of this Court concerning the constitutional issues herein, it is also respectfully urged that any adverse decision of this Court be declared prospective only in operation.

## ARGUMENT

### I

### *The California retaliatory tax is a valid exercise of the State's taxing power and does not violate the Commerce Clause of the United States Constitution*

In *United States v. Southeastern Underwriters Association*, 322 U.S. 533 (1944), this Court held that an insurance company which carried on its business in several states was engaged in interstate commerce and as such was subject to the provisions of the Sherman Act, 15 U.S.C. §§1, *et seq.* Prior to that decision, under the holding in *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1869), the business of insurance had

not been considered to involve interstate commerce. In the absence of federal regulation, the states had developed systems for regulating and taxing the insurance industry.

The reaction among the states and the insurance industry to the *Southeastern Underwriters* decision was profound. Many insurance companies refused to pay state insurance company taxes. *See* 91 Cong. Rec. 478-9, 1087, 1092 (1945). Several states amended or repealed their taxes on insurance companies. *See* G. A. Pelletier, Jr., "Insurance Retaliatory Laws," 39 Notre Dame Lawyer 243, 249 (1964). Congress responded to this situation by enacting the McCarran-Ferguson Act, 59 Stat. 33, 15 U.S.C. §§1011-1015. The McCarran-Ferguson Act's declaration of policy provides in pertinent part:

> "Congress declares that the continued regulation and taxation by the several states of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states." 15 U.S.C.§1011.

The import of this language is clear. Existing state schemes for the regulation and taxation of the insurance industry are not to be construed as violative of the Commerce Clause, Art. 1, Sec. 8, Cl. 3, U.S. Constitution. As interpreted by this Court in *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451, 452 (1962), the McCarran-Ferguson Act "... provided that the regulation and taxation of insurance should be left to the states, without restriction by reason of the Commerce Clause." State regulation and taxation of the insurance industry are not to be tested under Commerce Clause principles applicable where Congress has remained silent.

Thus, cases such as *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), which held certain provi-

sions of the New York stock transfer tax to be in violation of the Commerce Clause, do not serve as precedent in analyzing the constitutionality of state taxes on the insurance industry. By way of the McCarran-Ferguson Act, Congress has exercised its plenary powers under the Commerce Clause to authorize the states to regulate and tax the insurance industry in ways which might, had Congress remained silent, have been deemed to burden or discriminate against interstate commerce. *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 431 (1946).

It is beyond question that Congress can constitutionally exercise its power under the Commerce Clause by authorizing the states to impose burdens on interstate commerce. This Court so held in *Prudential Insurance Co. v. Benjamin*, stating:

> "The power of Congress over commerce exercised entirely without reference to coordinated action of the states is not restricted, except as the Constitution expressly provides, by any limitation which forbids it to discriminate against interstate commerce and in favor of local trade. Its plenary scope enables Congress not only to promote but also to prohibit interstate commerce, as it has done frequently and for a great variety of reasons. That power does not run down a one-way street or one of narrowly fixed dimensions. Congress may keep the way open, confine it broadly or closely, or close it entirely, subject only to the restrictions placed upon its authority by other constitutional provisions and the requirement that it shall not invade the domains of action reserved exclusively for the states." 328 U.S. at 434.

This principle was reaffirmed as recently as last term in *Lewis v. BT Investment Managers, Inc.*, __ U.S. __, 100 S.Ct. 2009 (1980). In *Lewis*, this Court held that the

State of Florida could not, consistently with the Commerce Clause, prohibit an out-of-state bank holding company from owning an investment advisory subsidiary doing business in Florida. While Congress can, if it chooses, restrict the flow of interstate commerce, it has not done so in the Bank Holding Company Act, 12 U.S.C. §§1841-1850.

To the contrary, in the McCarran-Ferguson Act, Congress has chosen to restrict the flow of interstate commerce with respect to the business of insurance. This Court so held in *Prudential Insurance Co. v. Benjamin*. At issue in *Benjamin* was the constitutionality of the McCarran-Ferguson Act and the constitutionality of South Carolina's gross premiums tax, which was imposed only upon foreign, and not domestic, insurance companies. After concluding that the McCarran-Ferguson Act was a valid exercise of congressional power under the Commerce Clause, this Court held that the South Carolina insurance premiums tax was among those state taxes which the McCarran-Ferguson Act affirmatively sanctioned.

The tax involved in *Benjamin* was not a retaliatory tax. That fact, however, is immaterial. The South Carolina tax fell only on foreign insurers. It was thus a far more hostile classification than that set up by a retaliatory tax which falls on a foreign insurer only if the insurer's state of domicile imposes higher taxes than those of the retaliating state. In short, *Benjamin* held that the McCarran-Ferguson Act could and did insulate an otherwise discriminatory state insurance tax from challenge under the Commerce Clause.

In two subsequent *per curiam* decisions, this Court reaffirmed its decision in *Prudential Insurance Co. v. Benjamin*. In *Prudential Insurance Co. v. Hobbs*, 328 U.S. 822 (1946), this Court affirmed without written opinion a decision of the Supreme Court of Kansas upholding three aspects of the Kansas insurance tax laws. These included

annual fees imposed upon foreign insurance companies, a premiums tax imposed only on foreign insurance companies, and the Kansas retaliatory tax. *See In re Insurance Tax Cases*, 160 Kan. 300, 161 P.2d 726 (1945). In *Prudential Insurance Co. v. Indiana*, 328 U.S. 823 (1946), this Court again affirmed without written opinion a decision of the Supreme Court of Indiana upholding the Indiana premiums tax which applied only to foreign insurance companies. *See State v. Prudential Insurance Co.*, 224 Ind. 17, 64 N.E.2d 150 (1945). In both of these opinions, this Court cited as controlling authority its prior decision in *Prudential Insurance Co. v. Benjamin*.

Accordingly, in not less than three prior decisions, this Court has upheld state taxes falling exclusively or more heavily on foreign insurers than on domestic companies. No sufficient reason now appears to support the overruling of those precedents. Thus, the McCarran-Ferguson Act, as construed by this Court, insulates the California retaliatory tax from challenge under the Commerce Clause.

## II

*Classification of foreign insurance companies for purposes of retaliatory taxation is permissible under the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.*

In its report on the McCarran-Ferguson Act, the House Committee on the Judiciary noted that state regulation and taxation of the insurance industry remained subject to the commands and prohibitions in the Constitution other than those of the Commerce Clause:

> "It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *South-*

> *eastern Underwriters Association* case. Briefly, your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States, subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as for instance, in *Allgeyer v. Louisiana*, (165 U.S. 578), *St. Louis Cotton Compress Co. v. Arkansas*, (260 U.S. 346), and *Connecticut General Insurance Co. v. Johnson*, (303 U.S. 77), which hold, *inter alia*, that a State does not have the power to tax contracts of insurance or reinsurance entered into outside its jurisdiction...." H. R. Rep. No. 143, 79th Cong., 1st Sess. 2-3 (1945).

All three of the decisions cited in the foregoing committee report are to the effect that a state may not impose its premiums tax on insurance transactions wholly outside its borders. No such issue is presented in the instant case. To the extent there is another constitutional issue relating to the California retaliatory tax, the question is whether or not the tax violates the Equal Protection Clause of the Fourteenth Amendment.

As this Court stated recently in *Parham v. Hughes*, 441 U.S. 347, 351 (1979):

> "State laws are generally entitled to a presumption of validity against attack under the Equal Protection Clause. (citation omitted) Legislatures have wide discretion in passing laws that have the inevitable effect of treating some people differently from others, and legislative classifications are valid unless they bear no rational relationship to a permissible state objective."

The presumption of validity is particularly strong with respect to state tax laws. This Court in *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359 (1973), stated:

> "Where taxation is concerned and no specific federal

right, apart from equal protection, is imperiled, the States have large leeway in making classifications and drawing lines, which in their judgment, produce reasonable systems of taxation."

The reasons for permitting the states to exercise broad discretion in devising their fiscal policies are plain. Members of a state legislature are necessarily closer to and more familiar with local conditions than this Court. *Madden v. Kentucky*, 309 U.S. 83, 88 (1939). In determining sources of revenue and methods of obtaining it, the states are acting in their sovereign capacities. Moreover, as this Court held in *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 526-528 (1959), a state taxing scheme which treats some taxpayers differently from others is valid under the Equal Protection Clause if "... any state of facts reasonably can be conceived that would sustain it."

Applying these principles, this Court has sustained against equal protection challenges, a state law which denied to the natural father but not the natural mother of an illegitimate child, the right to bring a wrongful death action, *Parham v. Hughes*; a state law which granted a property tax exemption to widows but not widowers, *Kahn v. Shevin*, 416 U.S. 351 (1973); state constitutional provisions which subjected corporations but not individuals to personal property taxes, *Lehnhausen v. Lake Shore Auto Parts Co.*; a state personal property tax which was five times greater on bank deposits held out-of-state than on bank deposits held in-state, *Madden v. Kentucky*; and a state law prohibiting foreign insurance companies but not domestic companies from inserting in their policies a limitation period of less than three years for asserting claims, *Metropolitan Company v. Brownell*, 294 U.S. 580 (1935).

Under these principles, the California retaliatory tax does not deny Appellant the equal protection of the laws. The tax

clearly bears a rational relationship to a permissible state purpose. That purpose is to encourage uniform tax rates on insurance companies throughout the nation. As concluded by the California Court of Appeal in *Atlantic Insurance Co. v. State Board*, 255 Cal. App. 2d 1, 62 Cal. Rptr. 784 (Cal.Ct. App. 1st Dist. 1967), that purpose has to some extent been achieved. Premium taxes on life insurance companies throughout the nation, for the most part, are close to two percent. *See* G. A. Pelletier, Jr., "Insurance Retaliatory Laws," 39 Notre Dame Lawyer 243, 247 (1964). As of 1976, twenty-seven states, including the District of Columbia, had a statutory premium tax rate of two percent; eight states had a statutory rate of three percent or higher, and the rate in the remaining jurisdictions was under two percent. *See* "An Overview of Retaliatory Tax Laws," Subcommittee on State Taxation of the American Council of Life Insurance.

As held by the California Court of Appeal in *Atlantic Insurance Co. v. State Board*:

> "[T]he purpose of the retaliatory law is to secure reciprocity. (citation omitted) It is designed to achieve uniformity of treatment and not to discriminate. In view of the relative uniformity of insurance taxation in the several states, the California law seems reasonably designed to accomplish its purpose. Therefore, we hold that for purposes of this tax, foreign insurers are classified separately on a rational basis and that there was no denial of equal protection." 255 Cal. App. 2d at 15.

Consequently, this is not a case where the difference in treatment was based *solely* on the out-of-state residence status of the taxpayer as was the case in *WHYY, Inc. v.*

*Borough of Glassboro*, 393 U.S. 117 (1968), relied upon by Appellant.

Finally, this Court in *Wheeling Steel Corp. v. Glander*, 337 U.S. 562 (1949) stated with respect to the Equal Protection Clause, 337 U.S. at 571-572:

> "After a state has chosen to domesticate foreign corporations, the adopted corporations are entitled to equal protection with the state's own corporate progeny, at least to the extent that their property is entitled to an equally favorable ad valorem tax basis."

Since the retaliatory tax is not an ad valorem property tax, cases such as *Wheeling Steel Corp. v. Glander*, also relied upon by Appellant, are inapplicable.

## CONCLUSION

Via the McCarran-Ferguson Act, Congress chose to exercise its power under the Commerce Clause by authorizing the states to tax the insurance industry without concern that their taxes may burden or discriminate against interstate commerce. Therefore, California's retaliatory tax does not violate the Commerce Clause. Moreover, the California retaliatory tax does not violate the Equal Protection Clause because it bears a rational relationship to a permissible state purpose and is imposed as a condition of doing business in the state. Therefore, as to the California retaliatory tax, the decision of the California Court of Appeal should be affirmed.

Respectfully submitted,

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## APPENDIX A

A.R.S. §20-230. *Retaliation*

A. When by or pursuant to the laws of any other state or foreign country any premium or income or other taxes, or any fees, fines, penalties, licenses, deposit requirements or other material obligations, prohibitions or restrictions are imposed upon insurers of this state doing business, or that might seek to do business in such other state or country, or upon the agents of such insurers, which in the aggregate are in excess of such taxes, fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions directly imposed upon similar insurers of such other state or foreign country under the statutes of this state, so long as such laws continue in force or are so applied, the same obligations, prohibitions and restrictions of whatever kind shall be imposed upon similar insurers of such other state or foreign country doing business in Arizona. Any tax, license or other obligation imposed by any city, county or other political subdivision of a state or foreign country on insurers of this state or their agents shall be deemed to be imposed by such state or foreign country within the meaning of this section. The provisions of this section shall not apply to ad valorem taxes on real or personal property or to personal income taxes or to assessments on or credits to insurers for the payment of claims of policyholders of insolvent insurers.

B. If an insurer domiciled in this state is refused authority to transact in another state insurance upon a plan and in a manner which is permitted for domestic insurers of such other state, notwithstanding that the insurer of this state is fully qualified for such authority in accordance with the applicable laws of such other state, and if such refusal is not

accompanied by a written statement of the grounds therefor, then and thereafter, and for so long as such refusal shall continue, the director may refuse to grant an initial certificate of authority, but not a renewal of an existing certificate of authority to any insurer domiciled in such other state which may seek to transact in this state a like kind or kinds of insurance.

Wis. Stat. 76.35 *Increase of fee of foreign company*

Whenever the laws of any other state of the United States or of any foreign country, or the rules, regulations, requirements or impositions thereof, or of any department or officer thereof shall require of insurance companies or fraternal benefit societies organized under the laws of this state and doing business in such state or foreign country or of their agents, any deposit of securities for the protection of their policyholders or otherwise, or any payment of taxes, fines, penalties, certificates of authority, license fees or otherwise, greater than the amount required by the laws of this state for the same purposes from similar companies or fraternal societies organized under the laws of such other state or foreign country and doing business in this state, or shall impose other obligations, prohibitions or restrictions additional to or in excess of those imposed by the laws of this state upon insurance companies or fraternal benefit societies of such other state or foreign country or their agents, then all such companies or fraternal benefit societies of such other states or foreign country doing business within this state shall make the same depsoit with the state treasurer and shall pay him the same sum for taxes, fines, penalties, certificates of authority, license fees or otherwise, and the same obligations, prohibitions or restrictions of whatever kind shall be imposed upon them and their agents as a condition to the issuance of a license to them, as is required to be made or paid or is imposed upon companies or societies of this state or their agents by the laws of such other

state or foreign country, or the rules, regulations, requirements or impositions thereof, or of any department or officer thereof.

Wis. Stat. 76.36 *Foreign insurance companies; reciprocal taxation*

When any insurance corporation or other insurer of this state shall be licensed to transact insurance in any other state, territory, or district of the United States, like insurance corporations or insurers from such other state, territory or district shall pay no other or greater taxes, fees, or licenses than are or would lawfully be imposed upon and collected from like insurance corporations or insurers of this state by such other state, territory or district; but the amount of such taxes or fees paid by insurance corporations or insurers subject to sections 76.34, 200.13 and 201.59, shall not be less than the amount required and applied as provided in said sections, and the amount of such taxes paid by insurance corporations or insurers under the provisions of subsection (1) of section 76.30 shall not be less than three-eights of one per centum on the amount of the gross premiums received for direct insurance, less the deductions provided in section 76.31, by such corporations or insurers during the preceding year in this state. This section shall not apply to insurance corporations or other insurers of any foreign country.

## CERTIFICATE OF SERVICE

EDWIN P. LEE, one of the attorneys for the amici curiae, and a member of the bar of this Court, certifies that he served the attorneys for the Appellant and Appellee in the forgoing case by forwarding two exact copies of the AMICI CURIAE BRIEF in a sealed envelope, first class postage prepaid, and deposited the same in the United States Mail addressed to:

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No. 79-1423

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

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ON APPEAL FROM THE COURT OF APPEAL
SECOND APPELLATE DISTRICT,
STATE OF CALIFORNIA

---

## BRIEF *AMICUS CURIAE* IN SUPPORT OF APPELLANT, SUBMITTED ON BEHALF OF THE LIFE INSURANCE COUNCIL OF NEW YORK

---

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November 19, 1980

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

No. 79-1423

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

*Appellant,*

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

*Appellee.*

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ON APPEAL FROM THE COURT OF APPEAL
SECOND APPELLATE DISTRICT,
STATE OF CALIFORNIA

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## BRIEF *AMICUS CURIAE* IN SUPPORT OF APPELLANT, SUBMITTED ON BEHALF OF THE LIFE INSURANCE COUNCIL OF NEW YORK

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### Preliminary Statement

Pursuant to Rule 36.2 of the Rules of this Court, this *amicus curiae* brief in support of appellant is filed with the written consent of appellant and appellee, on file with the Clerk of this Court.

## Interest of *Amicus Curiae*

The Life Insurance Council of New York [LICONY] is an association of life insurance companies formed under the Not-For-Profit Corporation Law of New York. The membership of LICONY is made up of 53 life insurance companies, each of which is organized and doing business under the laws of the State of New York. Approximately 99% of the legal reserve life insurance in force in New York and sold by New York domestic companies is accounted for by members of LICONY. These companies also account for approximately 20% of life insurance premiums in the United States. By virtue of their domicile in New York, these companies are subjected to retaliatory tax burdens imposed by other States in which they have established businesses under licenses granted by the States.[1] This brief is devoted solely to the retaliatory tax issue in the case.

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[1] New York imposes on both domestic and out-of-State life insurance companies a premiums tax of 1% and, usually, an income tax of 9% on net income allocated to New York, subject to an overall 2.6% of taxable premiums limitation. N.Y. Tax Law §§ 1501, McKinney 1975, 1502, 1505(a), 1510(b), McKinney Cum. Supp., 1980. Prior to 1974, New York taxed life insurance companies solely on the basis of premiums. 1973 N.Y. Laws Ch. 861, § 1 amending N.Y. Tax Law § 187(2)(b), (c); 1974 N.Y. Laws Ch. 649, §§ 2, 3, 13(c) amending N.Y. Tax Law § 187 and repealing it, as amended, effective January 1, 1974. Between 1968 and 1974, the State imposed differentially higher taxes on domestic companies than it did on out-of-State companies. *Id.* This discrimination by New York against domestic companies was initiated because of expanding revenue requirements and the potentially adverse impact on domestic companies which would have resulted from retaliation by other States if the New York tax rates applicable to out-of-State companies had been increased. State of New York Annual Budget Message, 1975-76, pp. A22-A24. New York domestic companies were forced to pay additional taxes to New York so as to forestall the imposition of rate increases on out-of-State companies, which would have triggered retaliation in the form of higher tax pay-

## Summary of Argument

Out-of-State insurers which have established businesses in a State under indefinite licenses were held under the pre-McCarran Act decisions to be protected by the Equal Protection Clause of the Fourteenth Amendment. The imposition by a State of more onerous tax burdens on such out-of-State insurers than on the State's own domestic corporations for the privilege of conducting an insurance business in the State was held to constitute a denial of Equal Protection of the Laws. The appellant, having established its insurance business many years ago under what the California courts have held constitutes an unequivocal license to do business in the State, could not have been subjected, under the pre-McCarran Act cases, to more onerous taxes than those imposed on California domestic insurance companies.

The California retaliatory tax does in fact impose on the appellant more onerous taxes than those levied on domestic insurers. The appellee's categorization of the California tax as a "reciprocal" tax is inappropriate. We are accustomed to allowances by many States of exemptions for gifts to out-of-State charities and deductions and credits to nonresidents, provided the State in which the charity operates or the nonresident's home State reciprocates by making

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ments to other States by New York companies. 1973 N.Y. Laws, Ch. 861, § 1 amending N.Y. Tax Law § 187(12)(a),(b).

In 1974, New York equalized the tax rates for out-of-State and domestic companies and added the net income tax to the existing premiums tax structure. 1974 N.Y. Laws Ch. 649, §§ 1, 13(a) enacting N.Y. Tax Law §§ 1501, 1502, 1510, effective January 1, 1974. In order to provide some relief for New York companies from the retaliatory taxes that they could expect from the new New York tax structure, including the equalization of out-of-State and domestic company tax rates, New York provided a credit to domestic companies for 90% of retaliatory taxes they might be required to pay to other States. N.Y. Tax Law § 1511(c), McKinney 1975.

similar allowances to charities or residents of the taxing State. The crucial difference between such reciprocal taxes and the California retaliatory tax is that they grant benefits to out-of-State taxpayers which the States are not required to grant as a constitutional matter, with or without reciprocity, whereas the California retaliatory tax imposes a burden or penalty on out-of-Staters that it clearly could not impose in the absence of the purported reciprocal feature, because the California tax discriminates against out-of-State insurers.

The McCarran Act does not validate the California retaliatory tax. There is nothing in the legislative history of the act to indicate that Congress intended to authorize discriminatory taxation of out-of-State insurers engaged in interstate commerce. It has been contended by the appellee that this Court held in *Prudential Insurance Company* v. *Benjamin* (328 U.S. 408 [1946]) that, by adopting the act, Congress lifted the Commerce Clause barriers to discriminatory taxation of out-of-State insurers holding indefinite licenses to conduct business in the State. The Solicitor General disagrees with that reading of the case.

In any event, it is clear that neither *Prudential Insurance Company* v. *Benjamin* nor any other decision of this Court has passed on the question as to whether Congress also sought by enacting the McCarran Act to lift Equal Protection Clause restrictions on the power of the States to discriminate against out-of-State insurers. The McCarran Act is directed solely to the Commerce Clause. There is no suggestion anywhere in the legislative history or the language of the act that it was directed to any of the restrictions imposed by the Equal Protection Clause on State taxation of out-of-State insurers. Instead, this Court has held to the contrary. (*State Board of Insurance* v. *Todd Shipyards*, 370 U.S. 451, 457 [1962]).

The McCarran Act should not be read as sanctioning the California retaliatory tax on out-of-State insurers for the further reason that such retaliatory taxation cannot be accommodated to our federalist structure. The premise underlying the appellee's entire argument is that retaliatory taxation constitutes a laudable fiscal policy, in that it tends to "achieve uniformity of treatment and not to discriminate." That contention is not borne out by the many decades of experience with retaliatory taxation of out-of-State insurers. Studies by economists, the conclusions of the National Association of Insurance Commissioners, the findings of State tax policy committees, and the views of other observers point to the conclusion that retaliatory insurance taxation does not promote uniformity, that it interferes with business across State lines, and that it should be abolished. The complications, difficulties and inconsistencies encountered in complying with retaliatory taxes and in their administration emphasize the arbitrariness and unfairness of the retaliatory tax structure. Such a system cannot be accommodated to the Equal Protection Clause of the Fourteenth Amendment in its role as an instrument of federalism.

## ARGUMENT

### I.

### Under the pre-McCarran Act Decisions, the California Retaliatory Tax Violates the Equal Protection Clause Because It Imposes More Onerous Taxation on Out-of-State Insurers That Have Established Businesses in the State Under Indefinite Licenses Than Is Imposed on Domestic Insurers.

#### A. *Out-of-State Insurers That Have Established Businesses in a State Under an Indefinite License Are Entitled to the Protection of the Equal Protection Clause Against Discriminatory Taxation.*

The cases decided by this Court hold that a foreign insurance company that has established an insurance business in a State under an indefinite license granted by the State is a "person within" the "jurisdiction" of the State and is, accordingly, protected by the Equal Protection Clause of the Fourteenth Amendment. (*Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 [1926]); *see Lincoln Life Insurance Co.* v. *Read,* 325 U.S. 673, 676 [1945]). It is also established that to "tax the foreign corporation for carrying on business . . . by a different and more onerous rule than is used in taxing domestic corporations for the same privilege, is a denial of the equal protection of the laws." (*Southern Railway Co.* v. *Greene,* 216 U.S. 400, 418 [1910]; *accord: WHYY, Inc.* v. *Borough of Glassboro,* 393 U.S. 117, 119 [1968]).

Out-of-State insurance companies which seek admission to a State for the first time, or which have been granted only annual renewable licenses to engage in business in the State have been held not to qualify for the protection of the Equal Protection Clause, because they have not yet be-

come a "person within its [the State's] jurisdiction". (*Philadelphia Fire Ass'n.* v. *New York,* 119 U.S. 110 [1886]; *Lincoln Life Insurance Co.* v. *Read, supra*).[2] The indefinite nature of the license to do business granted under the California statute to out-of-State insurers, including the appellant, which have thereupon established businesses in the State, brings the instant tax within the decisions invalidating discriminatory taxes.[3]

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[2] The instant case does not require the Court to consider the validity of this doctrine, since the appellant established its business in California under an indefinite license. The Life Insurance Council of New York, however, is prepared to contend in an appropriate case that this highly restrictive Nineteenth Century view of the Equal Protection Clause, like *Paul* v. *Virginia,* 75 U.S. (8 Wall.) 168 (1868) is no longer an appropriate interpretation in the late Twentieth Century, and that the Equal Protection Clause should be held generally to apply to foreign corporations seeking admission to do business in a State and to those that hold either indefinite or annual renewable licenses to do such business.

[3] The appellee was in error in contending in its reply brief to the brief *amicus* of the United States on the motion to dismiss this appeal that the appellant's California license was not "indefinite" (pp. 4-5). This matter was considered by the California Court of Appeals in *Atlantic Insurance Co.* v. *State Board of Equalization,* 255 Cal. App.2d 1, 62 Cal. Reptr. 784 (1st Dist. 1967), in which the court said:

> In the present case appellants point out that California, unlike most states, grants certificates of authority to transact insurance business for an indefinite period, subject to payment of a $10 annual fee. (Ins. Code, §701, §705 as amended by stats. 1963, ch. 1917, §1.) A certificate is not granted until the applicant conforms to requirements of California law prerequisite to its issue. After such issue the insurer must continue to comply with requirements of law. (Ins. Code, §700.)
>
> Unlike insurers who must obtain an annual license to conduct business, appellants appear to have obtained "unequivocal" licenses to do business. The fact that the California certificates of authority could be revoked for failure to pay taxes or to otherwise comply with the law (Ins. Code, §701) does not alter that position. *Hanover Fire Ins. Co.* v. *Harding, supra,* 272 U.S. 494, is said to stand for the proposition that once a foreign corporation has been unconditionally admitted

**B. *The California Retaliatory Tax Imposes a More Onerous Burden on Out-of-State Insurers Than Is Levied on Domestic Insurers and, Accordingly, Is Repugnant to the Equal Protection Clause.***

The court below held that the tax at issue did not violate the Equal Protection Clause, because it did not discriminate against foreign insurers (J.S. p. 33A). In so doing, the court followed an earlier California case, in which it had been stated:

> A franchise tax dependent on a foreign-domestic distinction alone is not a reasonable classification where both classes of corporation carry on essentially the same type of business. (*Southern Ry. Co.* v. *Greene* (1910) 216 U.S. 400, 417-418.) But here the purpose of the retaliatory law is to secure reciprocity. (*Bankers Life Co.* v. *Richardson, supra,* 192 Cal. 113, 124.) It is designed to achieve uniformity of treatment and not to discriminate. In view of the relative uniformity of insurance taxation in the several states, the California law seems reasonably designed to accomplish its purpose. Therefore we hold that for purposes of this tax foreign insurers are classified separately on a rational basis and that there was no denial of equal protection. [*Atlantic Insurance Co.* v. *State Board of Equalization,* 255 Cal. App. 2d 1, 15, 62 Cal. Reptr. 784, 793 (1967)].

We submit that this is error. The retaliatory increase of the appellant's California tax which is imposed generally at 2.35% of California premiums, to 2.5%, while California incorporated insurers paid a premiums tax of generally

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to do business in a state it must be granted equal protection. (272 U.S. at p. 514.) [255 Cal. App.2d at 13-14, 62 Cal. Reptr. at 792].

only 2.35%, is not validated by the fact that the increased tax was imposed by California because Ohio imposed on out-of-State insurers a premiums tax at the rate of 2.5%. (*See Western & Southern Life Ins. Co.* v. *State Board of Equalization,* 4 Cal. App. 3d 21, 25, 84 Cal. Rptr. 88, 91 [2d Dist. Ct. App. 1970]).

First, the California tax on Ohio insurers has all the components that this Court has always found offensive to the Equal Protection Clause, namely, a foreign corporation is subjected to more onerous tax burdens for the privilege of doing business in the State than domestic corporations engaged in the same business. Second, this Court recognized in *Wheeling Steel Corp.* v. *Glander* (337 U.S. 562 [1949]) that a reciprocity provision will not transform a tax that is otherwise discriminatory into a valid levy. In that case, an Ohio statute exempted from taxation certain accounts receivable owned by residents of the State, but taxed the receivables owned by nonresidents. The State contended that the tax was not discriminatory because it was part of the State's reciprocal statutory structure in taxing accounts receivable. This Court rejected that contention, saying:

> It is clear that this plan of "reciprocity" is not one which by credits or otherwise protects the . . . foreign corporation against the discriminations apparent in the Ohio statute. We think these discriminations deny appellants equal protection of Ohio law. [337 U.S. at 574].

The same is true of the California statute, since the retaliatory increase of appellant's California tax to the level of Ohio taxation of out-of-State insurance companies in no way protects appellant from being discriminated against

under the California tax vis-à-vis that State's domestic insurers.

As stated by Mr. Justice Brennan in a later case, the "Equal Protection Clause . . . [has as] its role to protect our federalism by denying . . . [a State] the power constitutionally to discriminate in favor of its own residents against the residents of other state members of our federation." (*Allied Stores of Ohio, Inc.* v. *Bowers,* 358 U.S. 522, 533 [1959]). That is the fatal defect in the California tax, notwithstanding its purported "reciprocity", since its effect is to discriminate in favor of California insurers against out-of-State insurers.

### C. *The California Retaliatory Tax Does Not Find Support in the Reciprocal Deductions, Exemptions and Credits Granted to Foreign Charities and Nonresidents Under State Death and Personal Income Tax Laws, Because Such Provisions Would Be Constitutional Without Allowances to Out-of-Staters.*

There are in force over the country provisions of State death and income tax statutes that grant out-of-State charities and nonresident individuals certain exemptions, deductions and credits that are allowed in-State charities and residents, but only if similar allowances are granted to charities and residents of the taxing State by the taxpayer's home State. But there is a crucial difference between such reciprocity provisions and the retaliatory tax here at issue. In State death taxation, for example, it is common practice to allow an exemption or deduction for gifts to charities organized and operating in other States, provided there is a reciprocal provision in the laws of the foreign charity's State allowing death tax exemption for similar gifts to charities of the taxing State. (1 P-H Inheritance & Transfer Tax Serv., ¶ 854). Such a reciprocal provision is constitutional only because neither the

Equal Protection Clause nor any other constitutional provision would prevent the State from denying the exemption or deduction altogether to out-of-State charities, even though the exemption or deduction is granted to in-State charities. (*Board of Education* v. *Illinois,* 203 U.S. 553 [1906]). Denial of exemption or deduction for gifts to out-of-State charities while granting them to in-State charities is a reasonable classification under the Equal Protection Clause, because the rationale back of deductions or exemptions for gifts to charities is that they relieve the State of costs and burdens of carrying on public functions it would otherwise engage in, and they perform other services benefiting the people of the State. (See Killough, "Exemptions to Educational, Philanthropic and Religious Organizations", Symposium on Tax Exemptions 23, Tax Policy League [1939]). Since out-of-State charities operating entirely outside the taxing State neither relieve the taxing State of any public functions nor perform any other services benefiting the people of the State, an exemption or deduction for gifts to such charities may be denied, even though there is an exemption for gifts to in-State charities.[4]

The same observation applies to the waiver by many States of death taxation of the estates of decedents who were domiciled in other States, but owned stocks in corporations organized under the laws of the taxing State. (*See* 1 P-H Inheritance & Transfer Tax Serv., ¶ 851). As

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[4] As stated by this Court in *WHYY, Inc.* v. *Borough of Glassboro,* 393 U.S. 117, 120 (1968):

> This is not a case in which the exemption was withheld by reason of the foreign corporation's failure or inability to benefit the State in the same measure as do domestic nonprofit corporations. Compare *Board of Education* v. *Illinois,* 203 U.S. 553.

a constitutional matter, the State has the power to tax such decedents on the transfer of such stocks at death. (*State Tax Comm'n.* v. *Aldrich*, 316 U.S. 174 [1942]). By waiving the tax on a reciprocal basis, the State is yielding a constitutional power it possesses.

There are other income tax deductions, exemptions and credits available to residents of a State that are granted to nonresidents only on a reciprocal basis. These are also to be distinguished from the California retaliatory tax. For example, some States exempt nonresidents from income taxes on wages, salaries and other personal service compensation, if the nonresident's home State grants a similar exemption from its income tax to residents of the taxing State. (Ky. Rev. Stat. § 141.070(2) [Cum. Supp. 1980], CCH Ky. State & Local Tax Serv. ¶10-707; Md. Ann. Code, art. 81, §291(b) [1975], CCH Md. State & Local Tax Serv. ¶10-207). Likewise, some States allow a nonresident a credit on account of income taxes paid to his home State on income derived from occupations, trades or businesses conducted, or property located, in the taxing State if the nonresident's home State grants a similar credit to residents of the taxing State. (Calif. Rev. & Tax Code §18002 [West 1970], Reg. §§17951-17954, P-H Calif. State & Local Tax Serv. ¶56,606-Q; W. Va. Code §11-21-40 [1974], CCH W. Va. State & Local Tax Serv. ¶15-330).

In the cases referred to, Kentucky and Maryland have the constitutional power to tax nonresidents on the income exempted from tax, regardless of whether there is a reciprocal exemption; and there is no constitutional mandate requiring California or West Virginia to grant nonresidents credits for taxes paid the home State on income derived from sources in California or West Virginia, with or without reciprocity. (*Shaffer* v. *Carter*, 252 U.S. 37

[1920]; *Travis* v. *Yale & Towne Manufacturing Co.*, 252 U.S. 60 [1920]).

The California retaliatory tax on out-of-State insurers is of a very different order. If California were to impose a higher premiums tax on out-of-State insurers holding indefinite licenses to do business in the State than that levied on domestic insurers, without reference to the level of premium taxation imposed on California insurers by the home States of the taxpayers, the tax would be struck down under the Equal Protection Clause, and, as we contend, the Commerce Clause, as discriminatory. (*Southern Railway Co.* v. *Greene, supra; WHYY, Inc.* v. *Borough of Glassboro, supra*). Hence, the California tax cannot be analogized to the reciprocal death and income taxes discussed above, because those taxes would be valid without their reciprocal features, whereas a California tax, imposed at a higher rate on Ohio insurers than on domestic insurers, would clearly be invalid, without regard to the level of Ohio taxes. The essential difference is that in the absence of the so-called reciprocal feature, the California retaliatory tax would clearly run afoul of the Equal Protection Clause, whereas the exemptions, deductions or credits discussed above that are granted to out-of-State charities or nonresidents on a reciprocal basis could be denied altogether.

Indeed, the California retaliatory tax is not properly characterized, as is done by counsel for the appellee, as a "reciprocal" tax. The term "reciprocal," as customarily used in the tax field, refers to the grant of a special allowance to taxpayers of other States, on condition that the State of residence or domicile of the taxpayer grant a similar allowance to residents or domiciliaries of the taxing State. As stated in a study of retaliatory insurance taxes:

> Reciprocity denotes a relation between two states which exists when each accords to citizens of the other certain privileges, on condition that its citizens also enjoy similar privileges at the hands of the other state. It is the return of a favor for a favor. On the other hand, as we have seen, retaliation is a return of disfavor with disfavor. [Pelletier, "Insurance Retaliatory Laws," 39 Notre Dame Lawyer, 243, 245-246 (1964)].

In the final analysis, the constitutional flaw in the attempt to impose higher taxes on out-of-State insurers than on domestic insurers in cases in which the taxpayer's home State taxes all insurers at a higher level is that the out-of-State insurer is subjected to more onerous taxes by the taxing State than are its own domestic insurers. That constitutional defect is in no way curable by whatever may be the tax structure of the home State of the out-of-State insurer. For as this Court stated in invalidating New Hampshire's tax on commuters:

> Nor . . . can the constitutionality of one State's statutes affecting nonresidents depend upon the present configuration of the statutes of another State. [*Austin* v. *New Hampshire,* 420 U.S. 656, 668 (1975)].

## II.

## The McCarran Act Did Not Validate the California Retaliatory Tax, Which Cannot Be Accommodated to Our Federalist Structure.

### A. *Neither the Language Nor the Legislative History of the McCarran Act Warrants an Interpretation of the Statute as Validating a Discriminatory Tax on an Out-of-State Insurer That Has Established Its Business in the State Under an Indefinite License.*

#### (1) Commerce Clause.

As a consequence of the decision in *United States* v. *South-Eastern Underwriters Ass'n.* (322 U.S. 533 [1944]), it was believed that the States could no longer debar out-of-State insurers from entering the State to do business, or impose discriminatory taxes on such insurers as a condition of the grant of a license to conduct such a business. Instead, out-of-State insurers engaging in a multi-state business in the State were now thought to be in the same constitutional posture as other foreign corporations seeking to conduct interstate businesses. (*See* the Congressional Committee Reports relating to the McCarran Act, p. 16, *infra*).

As the law then stood, no State tax could be imposed on a foreign corporation for the privilege of conducting an interstate business in the State. (*Cheney Brothers Co.* v. *Massachusetts,* 246 U.S. 147 [1918]).[5] Then came the Mc-

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[5] When the *Cheney Brothers* case and the so-called *Spector* doctrine (346 U.S. 602 [1941]) were overruled a number of years after the McCarran Act had been enacted (*Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274 [1977]), the long established principle, nevertheless, remained unchanged that in the silence of Congress, no State may impose a tax on out-of-State businesses that "discriminate[s] against interstate commerce." (*Id.,* 430 U.S. at 279).

Carran Act, which the court below held validates California's retaliatory tax against out-of-State insurers. That conclusion, we submit, was in error. There is nothing explicit in either the language of the act or its legislative history that suggests that Congress intended to authorize discriminatory taxation of out-of-State insurers. (*See* App. A; Report of House Committee on the Judiciary, H.R. Rep. No. 143, 79th Cong., 1st Sess. 2-3 [1945]; S. Rep. No. 20, 79th Cong., 1st Sess. [1945]; 91 Cong. Rec. 478-88, 1085-94, 1396, 1442-44, 1477-89 [1945]). As the Solicitor General has contended, in the absence of an explicit mandate from Congress to the contrary, "There is no reason why the tax provisions should be construed to permit anti-competitive taxation that discriminates against out-of-state insurers." (Br. Amicus for United States on motion to dismiss, p. 15).

However, it is argued by the appellee that *Prudential Insurance Company* v. *Benjamin, supra,* holds that in enacting the McCarran Act, Congress lifted the Commerce Clause barriers to discriminatory taxation against out-of-State insurers. (*See* Reply Br. to Br. Amicus of United States on motion to dismiss, pp. 2-3). The Solicitor General (at pp. 15-16) appears to reject that reading of the case as applied to the Commerce Clause. In any event, there is no question that the case did not consider the question as to whether Congress also sought by enacting the McCarran Act to lift Equal Protection Clause restrictions on the power of the States to discriminate against out-of-State insurers.

**(2) Equal Protection Clause.**

The McCarran Act provides that "silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation" of the business of insurance.

(§1011, App. A). It also provides that the business of insurance "shall be subject to the laws of the several States which relate to the regulation or taxation of such business." (§1012, App. A). This is unmistakably Commerce Clause language, and it is clear that it is directed to the effect of the silence of Congress on the powers of the States to tax insurers under the Commerce Clause. (*See* P. Hartman, State Taxation of Interstate Commerce, 24 *et seq.* [1953]; Sholley, "The Negative Implications of the Commerce Clause", 3 U. of Chicago L. Rev. 556, 583-588 [1936]). Likewise, the legislative history of the McCarran Act makes clear that the legislation was directed to the Commerce Clause restrictions on the State taxing powers.[6] Nowhere in any of the Committee Reports, or in the discussion of the bill on the floor of Congress, is there any suggestion that Congress was being asked, or sought, to exercise its powers under the Fourteenth Amendment in adopting the McCarran Act. Indeed, the House Judiciary Committee said:

> It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern Underwriters Association case.* [H.R. Rep. No. 143, 79th Cong., 1st Sess., 3 (1945)].

The *South-Eastern Underwriters* case dealt solely with the Commerce Clause, not the Equal Protection Clause. Moreover, this Court has noted that:

> Congress, of course, does not have the final say as to what constitutes due process under the Fourteenth

[6] *See* p. 16 *supra.* The legislative history of the McCarran Act is summarized in the brief for the United States as *amicus curiae* on the motion to dismiss the instant case (pp. 11-15).

> Amendment. And while Congress has authority by §5 of that Amendment to enforce its provisions (Ex parte Virginia, 100 U.S. 339; Monroe v. Pape, 365 U.S. 167), the McCarran-Ferguson Act does not purport to do so. [*State Board of Insurance* v. *Todd Shipyards*, 370 U.S. 451, 457 (1962)].

Consequently, whatever may be the powers that Congress possesses to relieve the States of the limitations of the Equal Protection Clause, it is clear from the course of the McCarran Act through Congress that that body was not seeking to exercise any such power. Accordingly, as the appellee recognizes (Appellee's Br. on motion to dismiss, p. 9), the prior law remained unchanged by the adoption of the McCarran Act with respect to the restrictions imposed by the Equal Protection Clause on discriminatory taxation of out-of-State insurers.

**(3) The Decisions Under the McCarran Act.**

There has been no decision of this Court that holds or suggests that Congress, in enacting the McCarran Act, purported to relieve the States of the prohibition of the Equal Protection Clause against discriminatory taxation of out-of-State insurers. In *Prudential Insurance Company* v. *Benjamin, supra,* following the adoption of the McCarran Act, this Court upheld a South Carolina premiums tax on out-of-State insurers that was not levied on domestic companies. In that case, the company held only an annual license to do business, not an indefinite license, so that the Equal Protection Clause was regarded as inapplicable to the case. Consequently, that case has no bearing on the instant case, since the appellant established its business in California under an indefinite license to conduct the insurance business in the State. Unlike Prudential,

the appellant is therefore protected by the Equal Protection Clause.[7]

*Prudential Insurance Company* v. *Hobbs* (328 U.S. 822 [1946]) is likewise not in point here, because in that case the State court was "unable to find in the record evidence to support the view that the tax in question on foreign insurance companies is greater than that levied on the home insurance companies." (*In re Insurance Tax Cases,* 161 P.2d 726, 734 [Kan. 1945]; *see* Appellant's Br. in opposition to motion to dismiss, p. 4.)

### B. *The California Retaliatory Tax on Out-of-State Insurers Cannot Be Accommodated to Our Federalist Structure.*

Underlying the entire argument of the appellee in this case is the premise that comparative retaliatory taxes reflect a laudable fiscal policy in that they tend to "achieve uniformity of treatment and not to discriminate." (Appellee's Br. on motion to dismiss, p. 10). The record of many decades of experience with State retaliatory taxation of out-of-State insurers is to the contrary.

A review of the structure of the taxation of life insurance companies by the States, as is done in Appendix B, demonstrates that there are marked variations in rates, tax bases and modes of taxation.

As is shown by Appendix B, the premiums tax (which is measured by gross receipts) is the major tax imposed by most States on insurers. Looking across the country, State by State, there are significant variations (before retalation) between the States in both the tax rate and

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[7] This case dealt only with the Commerce Clause, except to the extent that the taxpayer contended that if the McCarran Act should be construed as validating the tax at issue, the levy would violate the Due Process Clause of the Fifth Amendment; Article I, Section 8; Article I Section 1, as well as the Tenth Amendment (328 U.S. at 437, note 49). There was no contention made under the Fourteenth Amendment by Prudential in the *Benjamin* case.

the tax base, which provide a basis for widespread retaliation against out-of-State insurers. Thus, the Idaho tax of as much as 3% on life and health premiums of domestic insurers is 500% of the Nebraska tax of 0.6%. In the case of out-of-State insurers, the premiums tax on life and health premiums ranges from 1% in New York to 4% in Oklahoma, a 300% difference.

There are also significant variations in the base of the premiums tax. Eight States tax gross premiums, while the other 42 States reduce the gross premiums by policy or contract dividends in whole or in part. While 18 States tax annuity considerations, such receipts are exempted by 32 States.

There are numerous other variations among the States in taxing insurance companies, some of which are shown in Appendix B and others which are too numerous and varied there to be reflected. Thus, premium taxes are reduced in a number of States on account of the companies' investments in those States. In some States this provision is granted only to domestic corporations (e.g., Idaho), in other States only to foreign corporations (e.g., Oklahoma, Texas), and in still other States to both domestic and foreign insurers (e.g., New Mexico). By way of contrast, the laws of many States contain no reduction in rates by reason of investments in the States (e.g., California).

In some States premiums or annuity considerations from "qualified or exempt plans" (under the I.R.C.) are excluded from the tax base (e.g., Colorado, Kansas and New Jersey), whereas in other States such premiums or considerations are included in the tax base (e.g., California, Louisiana and New York).

In addition to premiums taxes there are a variety of other taxes imposed by the States. Some states impose a

tax based on net income (e.g., Minnesota, Florida, Illinois and New York) some of which allow a credit against the income tax for premium taxes (e.g., Minnesota). In other States that impose income taxes, the income tax is credited against the premiums tax (e.g., Nebraska), whereas in New York, for example, the income tax is in addition to the premiums tax without any credit.

There are significant variations in State retaliatory taxes. As summarized in the tables in Appendix C, most States utilize the "aggregate" method of comparison of the taxes, fees and other economic burdens on insurance companies by the various States involved. (*See* Pyle, "The Metamorphic Retaliatory Tax Law" (What Lies Ahead?)", 23 Ass'n of Life Insurance Counsel Proc. 857, 878 *et seq.* [1972]). This method requires a comparison of the taxes, fees and other economic burdens otherwise imposed on the taxpayer by State A (the taxing State) with the total burdens that would be imposed by State B (the taxpayer's State of domicile) on an insurer organized under the laws of State A, if it were doing business in State B to the same extent and in the same manner as the taxpayer conducts business in State A. The amount by which the State B aggregate exceeds the State A aggregate is the retaliatory tax owed by the taxpayer.

Some States use the "item-by-item" method of comparing taxes, which compares to specific taxes.[8] Not only does

[8] Thus, assume State A has a 2% premiums tax on out-of-State insurers, while New York imposes a 1% premiums tax and a 9% income tax. State A will first compare New York and State A's premiums taxes. Since the State A premiums tax exceeds the New York premiums tax, State A will impose no retaliatory tax on account of New York's premiums tax. State A, however, will then separately compare New York's income tax (9%) to its income tax (none). State A will then impose a retaliatory tax based on the full 9% income tax imposed by New York. This is so even though New York's tax burden measured in the aggregate may be less than State A's burden measured in the aggregate.

the item-by-item method complicate compliance but it may also lead to mutual retaliation. (*Id.* at 881 *et seq.*).

Retaliatory statutes are frequently applied regardless of whether an insurer from one State (State A) is doing business in the taxpayer's home State (State B).[9] Thus, when State A retaliates against an insurer from State B, it is necessary to compare the insurer's actual tax burdens in State A with the tax burdens of a hypothetical insurer from State A doing in State B the same volume and kind of business the taxpayer did in State A.

Moreover, retaliation is a one-way street. No State, including California, reduces the taxes of out-of-State insurers if their States of domicile provide lower taxes for out-of-State insurers than the taxing State. Cal. Ins. Code, §685 (West 1972).

These variations demonstrate how hollow is the claim that the retaliatory insurance tax structure has produced substantial uniformity of treatment of domestic and out-of-State insurers by the States.

A recent empirical study of the effects of retaliatory State taxation of insurance companies made by Dr. Jerry J. Bodily, a Department of Justice economist, is critical of the position taken by the appellee. The study found the following:

> The foregoing analysis shows that retaliatory provisions *have been of questionable value.* Though theoretically possible, they have not been the historical cause of low tax rates for the life insurers. *Neither have they helped promote uniformity of state premium*

[9] This is the case in California. At the present time there is no California life insurance company doing business in New York and hence no California life insurer is required to pay taxes in New York higher than the level of taxes in California. Nevertheless, New York companies are subject to retaliation by California.

> *rates.* However, there does exist a potential for retaliatory provisions to be used against the domestic insurers they were enacted to protect. It, therefore, seems in the best interests of both industry and state officials to examine seriously the effects of and need for these provisions. [Bodily, "The Effects of Retaliation On the State Taxation of Life Insurers," 44 J. of Risk & Insurance 21, 34 (1977); our emphasis.]

These conclusions come as no surprise, for as early as 1909 in a Kentucky case (involving the very appellant before this Court) the weaknesses and defects of the retaliatory system were denounced in eloquent and, indeed, Biblical terms:

> Retaliation rarely brings about the result aimed at. Its effect is usually to intensify the evil. It is strictly forbidden by Him who taught as one having authority and not as the scribes; and we are constrained to believe that the rule we have announced is more in keeping with the spirit of American institutions than the rule allowing taxes to be collected in one state, not for public necessity, but in retaliation for those collected in another State from foreign corporations doing business there. The state may exclude foreign corporations from doing business here if it sees fit, and it may impose such conditions as it sees fit to impose within the constitutional inhibitions. But the people of the state who desire insurance will not be benefited in the end by laws that drive foreign insurance companies from the state or cripple competition in the insurance business. [*Western & Southern Insurance Co.* v. *Commonwealth,* 133 Ky. 292, 117 S.W. 376, 378 (1909)].

Although the holding in the case quoted from was subsequently overruled (*Clay* v. *Dixie Fire Insurance Co.,* 168

Ky. 315, 181 S.W. 1123 [1916]), time has borne out the view that the retaliatory insurance tax system intensifies the "evil" purportedly sought to be dealt with. More than half a century later, the National Association of Insurance Commissioners adopted a resolution advocating elimination of discriminatory premium taxation, including retaliatory taxes, stating:

> Such laws embody a questionable public policy, and, moreover, establish a mechanism for tax suppression which is rapidly losing its effectiveness as against the contemporary revenue needs of the states. The result, certain to become more widespread in the future, is further unfairness in and further distortion of the premium tax system.
>
> . . .
>
> In summary, the task force finds the present system of premium taxation to be unfair and inappropriate to the contemporary insurance economy, and recommends, as a single and indivisible program, the elimination of premium tax discrimination between domestic and foreign companies, the elimination of premium tax discrimination among types of insurance organization or arrangement, and *the elimination of retaliatory premium taxes.* [Task Force Report, "Statement of Policy on Insurance Premium Taxation," unanimously adopted December 17, 1970, 1 Proc. Nat'l. Ass'n. of Insurance Comm'rs 69, 71 (1971); our emphasis.]

Other knowledgeable observers agree:

> In a fundamental sense, retaliatory clauses have the effect of damagingly curtailing efforts to place this levy in a meaningful position within a state's tax system. Furthermore, the states are virtually power-

> less to eliminate such content, since they have—through their individual actions—painted themselves into a corner. [Strickler, "The Mess in State Premium Taxation of Insurance Companies," Vol. 69, Nos. 9 and 10, Best's Rev. (Property/Casualty Ins. Ed.) 34 (1961), at p. 38, Part 1.]

Recently, a New Jersey Tax Policy Committee appointed by the Governor of that State, after studying retaliatory taxation of out-of-State insurers, found that "retaliatory taxes interfere with business across State lines," and recommended that:

> The system of discriminatory and retaliatory insurance taxes among the States should be abolished. . . . [Report of New Jersey Tax Policy Committee, Vol. V pp. 47, 50 (1972)].

The entire effort to compare one State's level of taxation with the level of taxation of another State is fraught with complication and uncertainty, and often results in arbitrary retaliation, not because it is justified under the statute, but because of difficulties of proof. We are not without experience with the "inequalities and hardships" that attempts to measure taxes of one State by the taxes of other States are likely to entail. (*See Salomon* v. *State Tax Comm'n.*, 278 U.S. 484, 491-492 [1929]). The Federal statutes for more than a century authorized the States to tax shares of stock of national banks, provided, *inter alia*, "the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks." (§5219 U.S. Rev. Stat., 12 U.S.C. §548). For the mass of litigation that has ensued over this provision, and the refinements, complications, obscurities and difficulties it has engendered, see S.E.

Leland, "The History and Impact of Section 5219 on the Taxation of National Banks," App. 6, in Report of Study Under P.L. 91-156, Board of Governors, Federal Reserve System, for the Senate Banking, Housing and Urban Affairs Committee [92nd Cong. 1st Sess. Dec. 1972]. These difficulties, complications and uncertainties in making the necessary tax comparisons emphasize the unacceptability under the Equal Protection Clause, of the retaliatory tax on insurers.

In summary as to the Equal Protection Clause, California here seeks to impose a higher tax on an out-of-State insurer for the privilege of doing business in the State than it imposes on its own domestic insurers for the privilege of conducting the same type of business. That such a levy cannot be accommodated to the Equal Protection of the Laws Clause of the Fourteenth Amendment and its role as an "instrument of federalism" is indicated by the opinion of Justice Brennan in *Allied Stores of Ohio, Inc.* v. *Bowers, supra,* in which he stated:

> The maintenance of the principles of federalism is a foremost consideration in interpreting any of the pertinent constitutional provisions under which this Court examines state action. Because there are 49 States and much of the Nation's commercial activity is carried on by enterprises having contacts with more States than one, a common and continuing problem of constitutional interpretation has been that of adjusting the demands of individual States to regulate and tax these enterprises in light of the multistate nature of our federation. While the most ready examples of the Court's function in this field are furnished by the innumerable cases in which the Court has examined state taxation and regulation under the

> Commerce and Due Process Clauses, still the Equal Protection Clause, among its other roles, operates to maintain this principle of federalism. [358 U.S. at 532.]

Accordingly, it is submitted that the retaliatory tax here at issue, as applied to a corporation conducting business in California under an indefinite license to do business in the State, which would have been repugnant to the Equal Protection Clause before the adoption of the McCarran Act, remains repugnant to that Clause, as well as to the Commerce Clause, since the enactment of that Act; and that there is no basis for holding the retaliatory tax nondiscriminatory because of the asserted benefits of retaliatory taxation.

## CONCLUSION

The judgment of the Court of Appeals of the State of California Second Appellate District should be reversed and the judgment of the Superior Court of California of the County of Los Angeles should be reinstated with respect to the retaliatory tax issue. (This brief is not directed to the principal office deduction issue).

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Respectfully submitted,

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# APPENDIX

# APPENDIX A

## Statutes

15 U.S.C. §1011. *Declaration of policy*

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

Mar. 9, 1945, c.20, §1, 59 Stat. 33.

15 U.S.C. §1012. *Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948*

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

Mar. 9, 1945, c.20, §2, 59 Stat. 34; July 25, 1947, c.326, 61 Stat. 448.

## APPENDIX B

### State Taxation of Legal Reserve Life Insurance Companies*

| State | Type of Company | Rate of Tax (%) L | H | A | Tax Base L | H | A | Income or Other General Tax | Retaliatory Statute |
|---|---|---|---|---|---|---|---|---|---|
| 1. Alabama | domestic | 1.0 | 1.0 | 1.0 | – | – | a | – | – |
| | foreign | 3.0 | 3.0 | 1.0 | – | – | a | – | Yes b |
| 2. Alaska | domestic | 1.5 | 1.5 | – | – | – | – | – | – |
| | foreign | 3.0 | 3.0 | – | – | – | – | – | Yes b |
| 3. Arizona | domestic | 1.0 | 1.0 | – | – | – | – | – | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes b |
| 4. Arkansas | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.5 | 2.5 | – | a | – | – | – | Yes b |
| 5. California | domestic | 2.35 c | 2.35 | 2.35 c | – | – | – | – | – |
| | foreign | 2.35 c | 2.35 | 2.35 c | – | – | – | – | Yes b |
| 6. Colorado | domestic | 2.25 | 2.25 | – | ac | a | – | – | – |
| | foreign | 2.25 | 2.25 | – | ac | a | – | – | Yes b |
| 7. Connecticut | domestic | 2.0 | 2.0 | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes b |
| 8. Delaware | domestic | 2.0 | 2.0 | – | – | – | – | – | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes b |

* (1) The term "domestic" refers to a life insurance company organized under the laws of the State indicated, and "foreign" refers to a life insurance company organized under the laws of another State. (2) "L" refers to taxable life insurance premiums, "H" refers to taxable health and disability insurance premiums, and "A" refers to taxable annuity considerations. (3) Unless otherwise noted, the tax base is gross direct premiums (or considerations) received less policy (or contract) dividends and is indicated by a dash under the Tax Base column. (4) A dash under the "Rate of Tax" column means that no tax is imposed. (5) Column headed "Income or Other General Tax" generally refers to revenue or privilege taxes other than premiums taxes or *ad valorem* property taxes.

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 9. Florida | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | 1.0 | a | a | a | Yes | Yes b |
| 10. Georgia | domestic | 2.25 | 2.25 | 1.5 | – | – | – | – | – |
| | foreign | 2.25 | 2.25 | 1.5 | – | – | – | – | Yes b |
| 11. Hawaii | domestic | 1.918 | 2.9647 | – | – | a | – | – | – |
| | foreign | 3.197 | 4.2824 | – | – | a | – | – | No d |
| 12. Idaho | domestic | 3.0 | 3.0 | – | c | – | – | – | – |
| | foreign | 3.0 | 3.0 | – | c | – | – | – | Yes b |
| 13. Illinois | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | Yes | Yes b |
| 14. Indiana | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes e |
| 15. Iowa | domestic | 2.0 | 2.0 | 2.0 | c | – | c | – | – |
| | foreign | 2.0 | 2.0 | 2.0 | c | – | c | – | Yes b |
| 16. Kansas | domestic | 1.0 | 1.0 | 1.0 | c | – | c | – | – |
| | foreign | 2.0 | 2.0 | 2.0 | c | – | c | – | Yes f |
| 17. Kentucky | domestic | – | – | – | a | – | a | Yes | – |
| | foreign | 2.0 | 2.0 | 2.0 | a | – | a | – | Yes b |
| 18. Louisiana | domestic | 1.7 | 1.7 | 1.7 | a | a | a | Yes | – |
| | foreign | 1.7 | 1.7 | 1.7 | a | a | a | Yes | Yes e |
| 19. Maine | domestic | 1.0 | 1.0 | 1.0 | c | – | c | – | – |
| | foreign | 2.0 | 2.0 | 2.0 | c | – | c | – | Yes b |
| 20. Maryland | domestic | 2.0 | 2.0 | – | – | – | – | – | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes b |
| 21. Massachusetts | domestic | 2.0 | 2.0 | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes gh |
| 22. Michigan | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | – | a | – | – | – | Yes b |

| State | Type of Company | Rate of Tax (%) L | H | A | Tax Base L | H | A | Income or Other General Tax | Retaliatory Statute |
|---|---|---|---|---|---|---|---|---|---|
| 23. Minnesota | domestic | 2.0 | 2.0 | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | Yes | Yes g |
| 24. Mississippi | domestic | 1.5 | 1.5 | 1.0 | c | – | c | Yes | – |
| | foreign | 3.0 c | 3.0 | 2.0 | – | – | c | Yes | Yes b |
| 25. Missouri | domestic | 2.0 | 2.0 | 2.0 | c | – | c | – | – |
| | foreign | 2.0 | 2.0 | 2.0 | c | – | c | – | Yes b |
| 26. Montana | domestic | 2.75 | 2.75 | – | – | – | – | – | – |
| | foreign | 2.75 | 2.75 | – | – | – | – | – | Yes b |
| 27. Nebraska | domestic | 0.6 | 0.6 | 0.6 | c | – | c | Yes | – |
| | foreign | 2.0 | 2.0 | 2.0 | c | – | c | Yes | Yes b |
| 28. Nevada | domestic | 2.0 | 2.0 | 2.0 | c | – | c | – | – |
| | foreign | 2.0 | 2.0 | 2.0 | c | – | c | – | Yes b |
| 29. New Hampshire | domestic | 2.0 | 2.0 | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | Yes | Yes g |
| 30. New Jersey | domestic | 2.0 | 2.0 | – | c | – | – | – | – |
| | foreign | 2.0 | 2.0 | – | c | – | – | – | Yes b |
| 31. New Mexico | domestic | 2.5 | 2.5 | – | – | – | – | – | – |
| | foreign | 2.5 | 2.5 | – | – | – | – | – | No d |
| 32. New York | domestic | 1.0 | 1.0 | – | – | – | – | Yes | – |
| | foreign | 1.0 | 1.0 | – | – | – | – | Yes | Yes fh |
| 33. North Carolina | domestic | 1.5 | 1.5 | 1.5 | ac | a | ac | – | – |
| | foreign | 2.5 | 2.5 | 2.5 | ac | a | ac | – | No d |
| 34. North Dakota | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.5 | 2.5 | – | – | – | – | – | Yes g |
| 35. Ohio | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.5 | 2.5 | – | a | a | – | – | Yes f |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 36. Oklahoma | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 4.0 | 4.0 | – | – | – | – | – | Yes b |
| 37. Oregon | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.25 | 2.25 | – | – | – | – | – | Yes b |
| 38. Pennsylvania | domestic | 2.0 | 2.0 | – | – | – | – | – | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes b |
| 39. Rhode Island | domestic | 2.0 | 2.0 | – | – | – | – | – | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes e |
| 40. South Carolina | domestic | 2.0 | 2.0 | – | – | – | – | – | – |
| | foreign | 3.0 | 3.0 | – | – | – | – | – | Yes e |
| 41. South Dakota | domestic | 0.75 | 0.75 | 0.5 | c | – | c | – | – |
| | foreign | 2.5 | 2.5 | 1.25 | c | – | c | – | Yes b |
| 42. Tennessee | domestic | 1.75 | 1.75 | 1.5 | c | – | c | Yes | – |
| | foreign | 2.0 c | 2.0 | 1.5 c | c | – | c | Yes | Yes e |
| 43. Texas | domestic | 1.1 | 1.1 | – | – | – | – | – | – |
| | foreign | 3.3 | 3.3 | – | – | – | – | – | Yes b |
| 44. Utah | domestic | 2.25 | 2.25 | – | – | – | – | – | – |
| | foreign | 2.25 | 2.25 | – | – | – | – | – | Yes b |
| 45. Vermont | domestic | 2.0 | 2.0 | – | – | – | – | – | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes e |
| 46. Virginia | domestic | 2.25 | 2.75 | – | a | a | – | – | – |
| | foreign | 2.25 | 2.75 | – | a | a | – | – | Yes b |
| 47. Washington | domestic | 1.0 | 1.0 | – | ac | a | – | – | – |
| | foreign | 2.0 | 2.0 | – | ac | a | – | – | Yes b |
| 48. West Virginia | domestic | 3.0 | 3.0 | 1.0 | a | a | a | – | – |
| | foreign | 3.0 | 3.0 | 1.0 | a | a | a | – | Yes b |
| 49. Wisconsin | domestic | – | – | – | – | – | – | Yes | – |
| | foreign | 2.0 | 2.0 | – | – | – | – | – | Yes e |
| 50. Wyoming | domestic | 1.5 | 1.5 | 1.0 | c | – | c | – | – |
| | foreign | 2.5 | 2.5 | 1.0 | c | – | c | – | Yes b |

## *Appendix B*

### *Descriptive Footnotes*

a No deduction is allowed for policy or contract dividends.

b Retaliatory statute, by its terms, requires that retaliatory taxes be computed by the "aggregate" method.

c Premiums or annuity considerations received from "qualified or exempt plans" are generally excluded from the tax base or are taxable at a different or lesser rate of tax.

d There is no generally applicable retaliatory statute.

e It is unclear whether retaliatory taxes are to be computed by the "aggregate" method or the "item-by-item" method.

f Case law requires that retaliatory taxes be computed by the "aggregate" method. *Employers Casualty Co.* v. *Hobbs,* 149 Kan. 774, 89 P.2d 923 (1939); *John Hancock Mut. Life Ins. Co.* v. *Pink,* 276 N.Y. 421, 12 N.E.2d 529 (1938); *Indemnity Ins. Co. of North America* v. *Stowell,* 172 Ohio 167, 174 N.E.2d 536 (1961).

g Retaliatory taxes are computed by the "item-by-item" method. Mass. Ann. Laws Ch. 63, § 21 (1978) (*cf. Firemen's Fund Ins. Co.* v. *Commissioner,* 325 Mass. 386, 90 N.E.2d 669 (1950)); Minn. Op. Att'y Gen. 254-d (April 12, 1941), 252-E (June 11, 1970); N.H. premium and retaliatory tax return blank providing that "New Hampshire retaliates on a 'Tax-for-Tax' and 'Fee-for-Fee' basis"; N.D. Op. Att'y Gen. (January 21, 1953), N.D. Ins. Dept. Letter (March 12, 1958).

h Reciprocal non-retaliation statute provides that the State's retaliatory statute will not be applied to companies domiciled in states having either no retaliatory statute or a similar reciprocal non-retaliation provision.

## APPENDIX C

### Summary of Retaliatory Statutes

*Table No. 1*—States having retaliatory statutes which by their terms utilize the "aggregate" method.

Alabama
Alaska
Arizona
Arkansas
California
Colorado
Connecticut
Delaware
Florida
Georgia
Idaho
Illinois
Iowa
Kentucky
Maine
Maryland
Michigan
Mississippi
Missouri
Montana
Nebraska
Nevada
New Jersey
Oklahoma
Oregon
Pennsylvania
South Dakota
Texas
Utah
Virginia
Washington
West Virginia
Wyoming

*Table No. 2*—States having retaliatory statutes which by judicial construction have been held to require use of the "aggregate" method.

Kansas
New York
Ohio

## *Appendix C*

*Table No. 3*—States having retaliatory statutes which have been administered by utilizing the "item-by-item" method.

Massachusetts
Minnesota
New Hampshire
North Dakota

*Table No. 4*—States having retaliatory statutes which are not clear as to whether they apply "item-by-item" or by use of the "aggregate" method.

Indiana
Louisiana
Rhode Island
South Carolina
Tennessee
Vermont
Wisconsin

*Table No. 5*—States having no generally applicable retaliatory statute.

Hawaii
New Mexico
North Carolina

*Table No. 6*—States having a reciprocal non-retaliation statute.

Massachusetts
New York

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1. Ala. Code §§ 27-3-29, 27-4-1, -4, -5 (1975).
2. Alaska Stat. §§ 21.09.210(a)-(c), .270, .69.390(c) (1966).
3. Ariz. Rev. Stat. §§ 20-224A, -224B, -230 (Cum. Supp. 1980).
4. Ark. Stat. Ann. §§ 66-2225, -2302(1), (2), 84-2004, -2006(2) (1980).
5. Cal. Const. art. 13, § 28 (West Cum. Supp. 1980); Cal. Ins. Code §§ 685, 685.1, .2 (West 1972); Cal. Rev. & Tax Code §§ 12201 (West 1970), 12202 (West Cum. Supp. 1980), 12221 (West 1970), 12222 (West Cum. Supp. 1980).
6. Colo. Rev. Stat. § 10-3-209(1), (2) (1973 & Cum. Supp. 1978).
7. Conn. Gen. Stat. Ann. §§ 12-201 to -203, -210, -210a, -211, -214 (West Cum. Supp. 1980).
8. Del. Code tit. 18, §§ 531, 702(a)-(c), 707 (1974).
9. Fla. Stat. Ann. §§ 220.02, .11 (West Cum. Supp. 1980), 624.509 (West 1972 & West Cum. Supp. 1980), 624.512, .514 (West 1972).
10. Ga. Code Ann. §§ 56-321 (1977), 56-1303 (Cum. Supp. 1980), 56-1305 (1977).
11. Haw. Rev. Stat. §§ 431-317 (1976), 431-318 (Cum. Supp. 1980).
12. Idaho Code §§ 41-340 (1977), 41-402 (Cum. Supp. 1980), 41-403 (1977).
13. Illinois Income Tax Act §§ 201, 205 (Ill. Ann. Stat. ch. 120, §§ 2-201, -205 (Smith-Hurd Cum. Supp. 1980)); Illinois Insurance Code § 409 (Ill. Ann. Stat. ch. 73, § 1021 (Smith-Hurd Cum. Supp. 1980)).
14. Ind. Code Ann. §§ 6-2-1-1(a), -7(k) (Burns Cum. Supp. 1980), 27-1-18-2, -20-12 (Burns 1975).
15. Iowa Code Ann. §§ 432.1, 505.14 (West Cum. Supp. 1980).
16. Kan. Stat. §§ 40-252A, -252D (Cum. Supp. 1979), 40-253 (1973).

17. Ky. Rev. Stat. Ann. §§ 136.320, .330 (1977), 304.3-270 (1971).

18. La. Rev. Stat. §§ 22:1061, :1062, :1066, :1068, :1079 (1978), 47:221, :227 (1970).

19. Me. Rev. Stat. tit. 24A, § 428 (1964), tit. 36, §§ 2511, 2513-2515 (1964).

20. Md. Ann. Code art. 48A, § 61 (1979), art. 81, §§ 135, 136 (1975 & Cum. Supp. 1979), 136A (1975).

21. Mass. Ann. Laws ch. 63, §§ 20, 21, 22A, 22B, 24A (1978), ch. 175, § 159 (1977), Spec. L. ch. 11, §§ 3-7, 10, 11 (1979); Mass. Gen. Laws 1932 ch. 63, § 20 (as amended by ch. 509, 1941 Mass. Acts); 1943 Mass. Acts, ch. 531, §§ 2, 3 (as amended by ch. 558, 1960 Mass. Acts).

22. Mich. Comp. Laws §§ 208.3, .35(d), 500.440, .446 (Mich Stat. Ann. §§ 7.558(3), .558(35)(d) (Callaghan 1978), 24.1440 (Callaghan Cum. Supp. 1980), 24.1441, .1446 (Callaghan 1972)).

23. Minn. Stat. Ann. §§ 60A.15 subd. 1, .19 subd. 6 (West Cum. Supp. 1980), 290.06 subds. 1, 3a(5), (West Cum. Supp. 1980), 290.35 (1962).

24. Miss. Code Ann. §§ 27-7-5(1), (2) (1972), 27-15-103, -109, -119 (Cum. Supp. 1980), 27-15-123, -125, -127 (1972).

25. Mo. Ann. Stat. §§ 148.340, .370 (Vernon 1976), 148.390 (Vernon Cum. Supp. 1980), 375.916 (1968).

26. Mont. Code Ann. §§ 33-2-705, -709 (1979).

27. Neb. Rev. Stat. §§ 44-150 (1978), 77-907 (Cum. Supp. 1980), 77-908, -909, -2734 (1976).

28. Nev. Rev. Stat. §§ 680A.330, 680B.030, .050 (1979).

29. N.H. Rev. Stat. Ann. §§ 77-A:2, :5 (Cum. Supp. 1979), 400-A:32, :35 (Cum. Supp. 1979).

30. N.J. Stat. Ann. §§ 17B:23-5 (West Spec. Pam. 1980), 54:18A-1, -3, -5 (West Cum. Supp. 1980), 54:18A-6 (West 1960), 54:18A-13, -20 (West Cum. Supp. 1980).

31. N.M. Stat. Ann. § 59-5-1 (1978).

32. N.Y. Ins. Law § 61(1) (McKinney 1966), 61(4) (McKinney Cum. Supp. 1980); N.Y. Tax Law §§ 1501 (McKinney 1975), 1502, 1505 (McKinney Cum. Supp. 1980), 1510 (McKinney 1975 and McKinney Cum. Supp. 1980), 1511(b), (c) (McKinney 1975).

33. N.C. Gen. Stat. §§ 105-228.5, .8 (1979).

34. N.D. Cent. Code §§ 26-01-05 (1978), 26-01-11 (Cum. Supp. 1979), 57-38-09(15), -11 (1972).

35. Ohio Rev. Code Ann. §§ 3905.41 (Page 1971), 5725.18, .19, 5729.03, .04, .06 (Page 1980).

36. Okla. Stat. Ann. tit. 36, §§ 624 (West Cum. Supp. 1979), 625, 628 (West 1976), tit. 68, §§ 2355(C), 2359 (West Cum. Supp. 1979).

37. Or. Rev. Stat. §§ 317.070, .080(11), .197 (1979), 731.816, .854 (1979).

38. Pa. Stat. Ann. tit. 40, § 50 (Purdon Cum. Supp. 1980), tit. 72, §§ 7901, 7902 (Purdon Cum. Supp. 1980).

39. R.I. Gen. Laws §§ 27-2-17 (1979), 44-17-1, -2 (1970).

40. S.C. Code §§ 38-5-320, -330, -340, -350, -380, -410, -480 (1977).

41. S.D. Compiled Laws Ann. §§ 10-44-1 (1967), 10-44-2 (Cum. Supp. 1980), 10-44-4, -5 (1967), 58-6-70 (1978).

42. Tenn. Code Ann. §§ 56-4-201, -204, -205, -209, -217, -218 (1980), 67-2702, -2902 (1976).

43. Tex. Rev. Civ. Stat. Ann. arts. 4769 (Vernon 1963), 7064a (Vernon Cum. Supp. 1980); Tex. Ins. Code Ann. art. 3.34 (Vernon Spec. Pam. Supp. 1979).

44. Utah Code Ann. §§ 31-14-4, -9 (1974).

45. Vt. Stat. Ann. tit. 8, §§ 3367, 3718 (1970), tit. 32, §§ 8551, 8554, 8555 (1970).

46. Va. Code §§ 38.1-87 (1976), 58-486 (1974), 58-490 (Cum. Supp. 1980), 58-491 (1974).

47. Wash. Rev. Code Ann. §§ 48.14.020, .021 (Cum. Supp. 1980), 48.14.040 (1961).

48. W.Va. Code §§ 33-3-14 (Cum. Supp. 1980), 33-3-14a, -14b, -15, -16 (1975).

49. Wis. Stat. Ann. §§ 601.31(v) (West 1980), 76.62, .65 to .67, .69 (formerly §§ 76.31, .34 to .36, .375) (West 1957 and West Cum. Supp. 1980).

50. Wyo. Stat. §§ 26-3-133, -4-103, -4-104 (1977).

No. 79-1423

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

---

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

---

ON APPEAL FROM THE COURT OF APPEAL, SECOND APPELLATE DISTRICT, STATE OF CALIFORNIA

---

## BRIEF FOR STATE OF NEW YORK AS AMICUS CURIAE

---

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**ON APPEAL FROM THE COURT OF APPEAL SECOND APPELLATE DISTRICT, STATE OF CALIFORNIA**

---

## BRIEF FOR STATE OF NEW YORK AS AMICUS CURIAE

---

The Attorney General of the State of New York is submitting this brief on behalf of the State of New York pursuant to Supreme Court Rule 36(4).

Jurisdiction was noted on October 5, 1980.

### Question Presented

Is it constitutional for California to levy a retaliatory tax in excess of the normal tax against companies domiciled elsewhere, because the state of their domicile taxes insurance companies at a rate higher than California does?

## INTEREST OF NEW YORK STATE

The question presented is of great interest to New York State because of the effect of similar retaliatory taxes on insurance companies domiciled within the State. A retaliatory tax is a tax imposed by a state against some foreign insurance companies at a higher rate than that imposed on domestic insurance companies. As an example of how such a tax works, suppose state "A" taxes insurance companies at 2% and state "B" taxes them at 5%. Under a retaliatory tax law, state "A" would surcharge a state "B"-domiciled insurance company an additional 3%. Since most retaliatory tax laws provide that the foreign insurance company shall be taxed at the higher rate used by its home state, it is possible for a foreign insurance company to be taxed at a rate not only higher than domestic companies, but also higher than some foreign companies domiciled in other foreign states.

Because most states have such a retaliatory tax against non-domiciled insurance companies, New York State has been forced to retain a similar retaliatory tax (NY Insurance Law § 61). Retaliatory taxes result in insurance companies domiciled in New York State paying more to do business in other states and has had a detrimental effect on their business operations.

In 1973, New York attempted to resolve the retaliatory tax problem which plagued its insurance industry (L 1973, ch 459). In attempting at a compromise the Legislature amended section 61 of its Insurance Law by adding a paragraph 4, which is still in effect and reads as follows:

> "4. The provisions of this section shall not apply to insurance companies organized or domiciled in a state or country, the laws of which do not impose retaliatory taxes or other charges or which grant, on a reciprocal basis, exemptions therefrom to insurance companies organized or domiciled in this state."

In the supporting memorandum to Governor Rockefeller Norman Gallman, the then Commissioner of the Department of Taxation and Finance, stated that subdivision 4 is intended to be a step in eliminating retaliatory taxation in the taxation of insurance companies by states. He also stated:

> "The addition of subdivision 4 by this bill is an attempt to eliminate retaliation among states and will be beneficial to New York. But, this will only be fully effective if similar provisions are adopted by all states imposing retaliatory provisions. (At this time there are 46 states which have retaliatory provisions.) I am informed that only Massachusetts has adopted a similar provision in an attempt to end retaliatory taxation by other states on Massachusetts' insurance companies. Thus, the immediate effect of this bill will be to end retaliation against New York companies doing business in Massachusetts."*

It was enacted in the hope that other states would follow suit and enact similar legislation providing for reciprocal exemption from the retaliatory tax. None have followed suit.

New York State is the domicile of 164 property insurance companies, 70 life insurance companies, 8 accident and health insurance companies, and 8 title insurance companies. Most of these companies do business outside New York as well as within the State and are adversely affected by the retaliatory tax. It is estimated that this adverse effect has been a prime factor in causing 19 insurance companies to move their domiciles from New York State to other states.** The assets of these 19 companies amounted to $6,735,659,000; their liabilities amounted to $5,326,105,000; their capital amounted to $156,864,000, and they had a surplus of $1,257,548,000. (Attached hereto, as Appendix A, is a chart prepared from information on file in the office of the New York State Insurance Department.)

Thus, when New York State companies are taxed at a higher rate, it adversely affects their ability to compete with other insurance companies, injuring the companies and eventually injuring the State. This is demonstrated by the fact that 19 insurance companies have left the State. The removal of the 19 insurance companies from New York resulted in the loss of countless jobs and related services and adversely affected its economy and the welfare of its citizens.

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* See Mass. Gen. Laws, Ch 63, § 24A.

** As documented by correspondence files of the New York Insurance Department.

## HISTORY

For many years insurance companies were held not to be engaged in commerce and therefore not subject to United States regulation (see *Paul v Virginia*, 75 US 168, 183 [1868]). However, in *United States v Southeastern Underwriters Ass'n.*, 322 US 533 (1944), this Court determined that insurance was commerce and subject to the Sherman Anti-Trust Act (15 USC §§ 1, & 2). To mitigate the effects of *Southeastern Underwriters* on the states' ability to impose taxes or fees on the privilege of insurance companies to do business within those states, Congress quickly enacted the McCarron-Ferguson Act, 59 Stat 33 (1945), 15 USC §§ 1011-1013, to permit such exactions. It also made the Sherman Act, the Clayton Act and the Robinson-Patman Act inapplicable to the insurance business. Nowhere did it authorize a retaliatory tax.

The question of the constitutionality of retaliatory taxes was considered shortly after the passage of the McCarron-Ferguson Act. In *Prudential Ins. Co. v Benjamin*, 328 US 408 (1946), it was held that what might otherwise be an unconstitutional discriminatory tax was legitimized because of the McCarron Act. *Benjamin*, however, implied that where "a clear and gross evil" is created by a retaliatory tax, it would be illegal (p 436).

## ARGUMENT

### THE McCARRON-FERGUSON ACT DID NOT AUTHORIZE AND COULD NOT AUTHORIZE TAX STATUTES WHICH VIOLATE THE COMMERCE CLAUSE OF THE CONSTITUTION AND THE EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT.

(1)

New York State is relying on the briefs presented by the appellant here on the question of the unconstitutionality of a retaliatory tax as violating both the Commerce Clause and the Fourteenth Amendment to the Constitution and on the proposition that the McCarron-Ferguson Act could not empower states to enact such a tax.

The McCarron-Ferguson Act only restored the power of a state to levy taxes to support its government. Thus, in *State Board of Insurance v Todd Shipyards Corp.*, 370 US 451 (1962), a tax on the insurance of properties located in Texas owned by the defendant, a New York corporation, when the insurer was not licensed in Texas and when the premiums were paid in New York, was declared unconstitutional. It was held that the McCarron-Ferguson Act could not justify such a tax. The fact that insurance companies were involved did not permit violation of either the Commerce Clause or of the Fourteenth Amendment by states.

Before *Southeastern Underwriters* and McCarron-Ferguson this Court in *Hanover Fire Ins. Co. v Harding*, 272 US 494 (1926) had held that when a foreign insurance company obtained a license to do business in a state*, the state could not discriminatorily tax it. Thus a foreign insurance company could not be required to pay a higher tax on its personal property than that required from a domestic insurance company. Similar holdings are *Southern Railway Co. v Greene*, 216 US 400 (1910); *Bethlehem Motors Co. v Flynt*, 256 US 421 (1921); *Connecticut Gen. Life Ins. Co. v Johnson*, 303 US 77 (1938).

It is, thus, clear that a tax imposed on a foreign corporation licensed to do business in a state may not be discriminatory.

(2)

The argument that a state might reverse the adverse effects of other states' retaliatory taxes by reducing the taxes it levies on insurance companies to the lowest prevailing rates, and thus not subject its domestic insurance companies to retaliatory taxes, does not relieve the unconstitutionality of retaliatory taxation. In *Austin v New Hampshire, et al.*, 420 US 656 (1975), this Court said (pp 666-667):

> "[W]e do not think the possibility that Maine could shield its residents from New Hampshire's tax cures

* The appellant herein states that it has had an indefinite license to do business in California since 1956 (Brief of United States in Support of Noting Probable Jurisdiction [p 8]).

> the constitutional defect of the discrimination in that tax. In fact, it compounds it. For New Hampshire in effect invites appellants to induce their representatives, if they can, to retaliate against it."

Reducing tax rates to the lowest level is not required of a state to shield its industry from burdensome taxes imposed by other states. Economic threats should not be used on a state by other states to compel legislative action. A state should be at liberty to pursue taxation for the purpose of producing revenue without threat of retaliation against its citizens.

(3)

More than thirty-five years have passed since the enactment of McCarron-Ferguson and more than thirty-four years have passed since this Court considered *Prudential Ins. Co. v Benjamin, supra.* The serious consequences to the insurance business and to the states in which the insurance companies are domiciled resulting from these retaliatory taxes can now be seen. It is time that the McCarron-Ferguson Act be interpreted so as not to allow discriminatory action by states. It follows, therefore, that the California tax law, which is discriminatory, should be declared unconstitutional.

## CONCLUSION

THIS COURT SHOULD REVERSE THE JUDGMENT OF THE COURT OF APPEALS, SECOND APPELLATE DISTRICT, STATE OF CALIFORNIA, AND DECLARE THAT THE CALIFORNIA INSURANCE CODE, § 685, IS UNCONSTITUTIONAL.

Dated: Albany, New York
November 20, 1980

Respectfully submitted,

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# APPENDIX A

## TABLE OF INSURANCE COMPANIES WHICH HAVE LEFT NEW YORK STATE

| Company | Year Moved | New Domicile |
|---|---|---|
| Home Insurance Co. | 1973 | New Hampshire |
| Great American | 1976 | Ohio |
| National Reins Corp. | 1977 | Delaware |
| Puritan Insurance Co. | 1977 | Connecticut |
| London Guarantee | 1977 | Delaware |
| Glens Falls | 1977 | Delaware |
| Niagara Fire | 1977 | Delaware |
| Continental | 1977 | New Hampshire |
| Buffalo Reins | 1977 | New Hampshire |
| Phoenix Assurance | 1977 | New Hampshire |
| Fidelity & Casualty | 1977 | New Hampshire |
| American Reins | 1978 | Delaware |
| First International Reins | 1978 | Delaware |
| North Star Reins | 1978 | Delaware |
| Hudson | 1978 | Delaware |
| Skandia | 1978 | Delaware |
| American & Foreign | 1980 | Delaware |
| Globe Indemnity | 1980 | Delaware |
| Royal Indemnity | 1980 | Delaware |
| **Total** | | |

| Assets | Liabilities | Capital | Surplus |
|---|---|---|---|
| 1,319,479,000 | 1,033,171,000 | 20,973,000 | 265,334,000 |
| 902,999,000 | 699,274,000 | 15,440,000 | 188,284,000 |
| 193,962,000 | 147,011,000 | 5,000,000 | 41,951,000 |
| 49,276,000 | 29,561,000 | 2,500,000 | 17,246,000 |
| 67,076,000 | 52,450,000 | 1,600,000 | 13,027,000 |
| 68,557,000 | 52,847,000 | 2,000,000 | 13,709,000 |
| 67,325,000 | 53,392,000 | 10,000,000 | 3,934,000 |
| 969,195,000 | 792,800,000 | 53,566,000 | 122,829,000 |
| 78,060,000 | 61,085,000 | 3,200,000 | 13,775,000 |
| 156,996,000 | 122,435,000 | 5,000,000 | 29,561,000 |
| 295,566,000 | 237,918,000 | 10,000,000 | 47,647,000 |
| 1,104,291,000 | 943,497,000 | 8,235,000 | 152,560,000 |
| 22,563,000 | 14,775,000 | 2,350,000 | 5,438,000 |
| 148,911,000 | 100,603,000 | 3,000,000 | 45,308,000 |
| 69,800,000 | 56,232,000 | 2,500,000 | 11,068,000 |
| 321,204,000 | 252,177,000 | 2,500,000 | 66,526,000 |
| 127,647,000 | 101,477,000 | 2,600,000 | 24,000,000 |
| 458,574,000 | 345,048,000 | 3,900,000 | 113,526,000 |
| 312,178,000 | 230,352,000 | 2,500,000 | 81,825,000 |
| 6,735,659,000 | 5,326,105,000 | 156,864,000 | 1,257,548,000 |

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Second Appellate District,
State of California

## AMICUS BRIEF OF THE STATE OF TENNESSEE IN SUPPORT OF THE STATE OF CALIFORNIA

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## AMICUS BRIEF OF THE STATE OF TENNESSEE IN SUPPORT OF THE STATE OF CALIFORNIA

### PRELIMINARY STATEMENT

Pursuant to Rule 36.4 of the Rules of this Court, the Attorney General of the State of Tennessee, on behalf of the Tennessee Department of Insurance, files this amicus curiae brief in support of the Appellee, the State Board of Equalization of the State of California.

### INTEREST OF AMICUS CURIAE

The State of Tennessee has a comparative retaliatory tax statute similar in function to the law of California being

challenged in this action. The State wishes to assert the constitutionality of its statute and of comparative retaliatory tax statutes in general. This brief is devoted solely to the retaliatory tax issue in this case.

## SUMMARY OF ARGUMENT

The comparative retaliatory insurance laws of the many states can withstand intense constitutional scrutiny and should be upheld. The opportunity to reaffirm and strengthen *Prudential* v. *Benjamin,* 328 U.S. 408 (1946), should be seized.

The passage of the McCarran-Ferguson Act was an explicit statement by Congress of its intent to exercise indirectly its plenary powers over commerce by bestowing upon the states the capability to place limitations on interstate commerce where normally the states could not interfere. State regulation and taxation of the insurance industry thrived prior to the passage of the Act; the existing state systems, and those to be developed, were recognized by and validated by Congress' action. *Prudential* v. *Benjamin* has long stood for this proposition. This combination of concurrent federal and state action is a potent expression of our governmental system and is in harmony with the grant to Congress of plenary powers over commerce.

Even had Congress not spoken, there would exist no Commerce Clause obstacle to the state comparative retaliatory insurance laws. These statutes are not inimical to the concept of free trade among the states. Obviously, they affect interstate commerce; equally obvious, they do not construct insuperable barriers to the participation of foreign insurors in the individual states' economies. Tennessee may be used as an example. Tennessee has far more foreign insurors doing business in the state than domestic companies, and the volume of business done by these insurors far exceeds retaliatory assessments paid. The burden placed on interstate commerce by assessments under the comparative retaliatory statute is minimal; the benefits derived from doing business in Tennessee are substantial.

The Equal Protection Clause also does not bar these state statutes. That the states have a legitimate interest in the regulation and taxation of the insurance industry has long been acknowledged. To equalize tax burdens and thus create a competitive atmosphere for their insurance companies, states have chosen to accord certain foreign insurors different treatment under comparative retaliatory insurance statutes. The method of classification used by the statutes is narrowly drawn to affect only those foreign insurors whose states of origin impose excessive barriers to the entry into their marketplace of the other states' insurors. The statutes thus do not constitute an invidious discrimination against insurors based solely on the fact that they come from outside the taxing state. The classifications work toward an equalization of tax burdens, foster competition, and allow reciprocal treatment where appropriate. The constitutionality of these statutes should be affirmed.

## ARGUMENT

### I.

### Reciprocal And Retaliatory Insurance Laws

### A. Background and General Purpose

Tennessee's reciprocal insurance tax law originally enacted in 1945, is found at Tenn. Code Ann. §56-4-218. See Appendix, at (p. A-1), for full text. It is basically similar to statutes found in almost all jurisdictions. *See* Pelletier, *Insurance Retaliatory Laws,* 39 Notre Dame Law 243 (1964), for a general overview and survey of this subject. This form of legislation has been in existence for over a hundred years and represents the efforts of the individual states to regulate the insurance business. In 1869, the United States Supreme Court held that insurance was not interstate commerce under the Commerce Clause and was, therefore, subject to state regulation. *Paul* v. *Virginia,* 75 U.S. 168 (1869). In view of a decision which departed from this principle, *United States* v. *South-Eastern Underwriters Association,* 322 U.S. 533 (1944), Congress in 1945 enacted the McCarran-Ferguson Act, 15 U.S.C. §§1011-1015, which sanctioned the scheme of state supervision of the insurance industry which had grown over the years and approved state regulation and taxation including by extension the state retaliatory tax schemes theretofore existing.

The scope and character of the state regulations and taxes varies somewhat from state to state because each state's plan evolved separately, but generally provisions were enacted as regulatory measures to protect insurance companies doing business in other states. The statutes were not originally designed to produce revenue, although this result may arise in a state having few domestic insurance companies. Pelletier, *Insurance Retaliatory Laws,* 39 Notre Dame Law 243 (1964). The general legislative purpose of retaliatory insurance laws and the way they function is well stated in *Republic Ins. Co.* v. *Commis-*

*sioner of Taxation,* 272 Minn. 325, 138 N.W. 2d 776, 779 (1965):

> It may be said generally that states have enacted these laws to protect insurance companies doing business in other states. The theory of the state is that foreign insurance companies should be subject to the same burdens as domestic insurance companies doing business in any foreign state. These statutes are primarily regulatory, the taxing feature being regarded as incidental. In some instances, statutes of various states so complement each other as to achieve an equalization on the basis of reciprocity. But in the absence of such an accommodation, the application of the retaliatory sanctions results.

When the Tennessee legislature reenacted its retaliatory insurance law in 1957, it stated these purposes in the preamble to the Act. See Appendix, at (p. A-3 ), for the preamble to Chapter 185, Public Acts of 1957. The legislative purpose and the express language of Tenn. Code Ann. §56-4-218 require the imposition of the retaliatory tax when the foreign jurisdiction comparatively discriminates against Tennessee insurors doing business in that jurisdiction. The Tennessee Supreme Court, construing the statutory provision, observed in *Williams* v. *Thomas Jefferson Ins. Co.,* 215 Tenn. 356, 365, 385 S.W. 2d 908, 911 (1965):

> As said above, the retaliatory or reciprocity provision, §[56-4-218], is a mandatory requirement that the same amount of tax be levied by the Commissioner upon a Kentucky insurance company doing business in Tennessee as Kentucky would levy upon a Tennessee company doing business in Kentucky.
>
> * * *
>
> By the retaliatory statute, the company is required to pay what other states require to be paid and, thus, brings in more revenue to this State.

The Court also stated:

> We feel that the conclusion above reached by the Chancellor is and was the intention of the Legislature, that is, that a foreign insurance company doing business in this state should pay the same amount of tax as would be levied upon a Tennessee company doing business in such foreign state. 215 Tenn. at 365, 385 S.W. 2d at 912.

**B. The Operation of Tennessee's Statute**

Tenn. Code Ann. §56-4-218 provides for a tax to be paid by certain out-of-state insurance companies and is based on the theory of reciprocity. The assessment of a tax based under this statute is triggered only when taxes and other burdens imposed by other jurisdictions on Tennessee insurance companies are in excess of such taxes and burdens imposed by Tennessee upon insurance companies from that same jurisidiction. Where these circumstances exist, the commissioner of insurance is authorized to tax the foreign insuror doing business in Tennessee at the same premium tax rate, or using the same restrictions or prohibitions, as that used in the state of origin of the foreign insuror against Tennessee businesses.

The commissioner computes the burden of tax or similar assessments on an aggregate statewide basis. To determine whether another state would impose an excessive tax burden on a Tennessee company doing business in that state, the commissioner computes the burden of premium taxes on the basis of the basic premium tax rate levied by the other state. This computation is made without reduction in the basic premium tax rate for either investments a like Tennessee company might qualify for in that state or as a result of investments such company may have made in Tennessee securities. The foreign insuror is not allowed to claim a reduction in the rate computed by the commissioner on the basis of the foreign state's statute. If this computation reveals that the state of origin of the foreign insuror doing business in Tennessee imposes a burden on Ten-

nessee companies doing business there which exceeds the tax burden Tennessee would place on foreign insuror, then a retaliatory tax is assessed.

The reciprocity of treatment yields, then, a retaliatory tax on foreign companies doing business in Tennessee based on the taxing, or other restrictive, treatment that the foreign company's domiciliary state accords Tennessee companies doing business in that state. The object of the statute is to reach a general equalization of burdens between Tennessee companies doing business out-of-state with any company from that state which is participating in Tennessee's marketplace. *Williams* v. *Thomas Jefferson Insurance Co.*, 215 Tenn. 356, 385 S.W. 2d 908 (1965). The statute insures that a "foreign insurance company doing business in this State [pays] the same amount of tax as would be levied upon a Tennessee company doing business in such foreign state." *Williams,* 215 Tenn. at 365, 385 S.W. 2d at 912. If the tax burden or other restrictions borne by the Tennessee company doing business in a foreign jurisdiction are not greater than those borne by a company from that jurisdiction doing business in Tennessee, no additional tax is authorized. As discussed in *Williams* v. *Thomas Jefferson Insurance Co.*, 215 Tenn. 356, 385 S.W. 2d 908 (1965), Tennessee does have a statutory provision which, basically, provides for a reduction or credit against its gross premiums tax for investments in Tennessee securities. *See* Tenn. Code Ann. §56-4-210. These statutory sections are to be read in harmony together, and the foreign insuror may take advantage of the credit provision after the commissioner has made his computations pursuant to Tenn. Code Ann. §56-4-218. *See Williams,* 215 Tenn. at 365, 385 S.W. 2d at 910-11.

## II.

### The McCarran-Ferguson Act

The McCarran-Ferguson Act, 15 U.S.C. §§1011-1015, does authorize the state statutes, such as the California statute under scrutiny here, which levy a comparative retaliatory tax on the premiums of certain insurance companies.

The McCarran-Ferguson Act was passed in the wake of *United States* v. *South-Eastern Underwriters Association,* 322 U.S. 533 (1944), in which this Court overruled the long-held concept that the insurance business was a purely local matter. Prior to *South-Eastern Underwriters* a substantial body of state regulatory and taxing law had developed regarding the insurance industry, based on the premise that insurance was not interstate commerce. *Cf. Paul* v. *Virginia,* 75 U.S. (8 Wall.) 168 (1869). Coming soon after the decision in *South-Eastern Underwriters,* the McCarran-Ferguson Act confirmed the states' powers over the insurance industry, giving congressional backing to existing and future state law on the subject by stating:

> Sec. 2.(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business. 15 U.S.C. §1012.

At the time of the passage of the Act, the Congress was acquainted with the extensive and disparate nature of the states' regulation and taxation of the insurance industry. *See Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408, 430 (1946). Although much is made of the fact that Congress intended to give the states "no more powers than they previously had," it may be inferred from the remarks of Congressional members that the extensive nature of the already existing state power was being recognized and that the Congress anticipated only that matters such as contracts of insurance and re-insurance entered into outside a state's jurisdiction would be outside the state's

authority to regulate and tax. *See State Board of Insurance* v. *Todd Shipping Co.,* 370 U.S. 451, 455-56 (1962).

Thus Congress, pursuant to its plenary powers over commerce, has affirmatively and emphatically designated the states as the general regulatory and taxing authority in the field of insurance. This congressional action brought together the concurrent powers of both governments, state and federal, the strongest expression of regulatory and taxing power possible under our system of government. *Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408, 435-36 (1946); *Pennsylvania* v. *Wheeling & Belmont Bridge Co.,* 59 U.S. 421 (1956). By enacting the McCarran-Ferguson Act, Congress has exercised its power to remove Commerce Clause restrictions on state regulation and taxation of insurance companies; it has carved out an area in which state statutory law may operate free from the restraints which Congress might impose pursuant to its plenary powers over commerce. *See Lewis* v. *B.T. Investment Managers, Inc.,* 48 L.W. 4638, 4653 (1980).

III.

**The Commerce Clause**

Even if the relevant state statutes are scrutinized independently of federal legislation, they will be found constitutional; they are not inimical to the free trade concept underlying the Commerce Clause. These state statutes do affect interstate commerce, but they do not burden it to such an extent nor in such a manner that they must fall in the face of the constitutional attack.

It is universally observed that the purpose of the Commerce Clause was to create free trade among the states, trade uninhibited by excessive interference by the states. *Freeman* v. *Hewit,* 329 U.S. 249, 251-52 (1946); *McLeod* v. *J.E. Dilworth Co.,* 322 U.S. 327, 330-31 (1944). The Commerce Clause is a positive grant to Congress of plenary powers over interstate commerce; it is also a restriction on the states against erecting

barriers against that commerce. *See, e.g., Hughes* v. *Oklahoma,* 441 U.S. 322, 326 (1979); *Philadelphia* v. *New Jersey,* 437 U.S. 617, 623 (1978). Where Congress has not spoken, however, the states may legislate to protect legitimate local interests even though interstate commerce may be affected. *See, e.g., Great A&P Tea Co.* v. *Cottrell,* 424 U.S. 366, 371 (1976). Different treatment of units of interstate commerce must be based, however, on some criterion other than solely a foreign origin to survive a challenge under the Commerce Clause. *Philadelphia* v. *New Jersey,* 437 U.S., at 626-27. The goal of the states must be ultimately to avoid regulation affecting interstate commerce which is in essence merely a form of economic protectionism. *Philadelphia* v. *New Jersey,* 437 U.S., at 624. States may not isolate themselves economically; to do so is to take action which is obviously inimical to the concept of free trade. *See Baldwin* v. *G.A.F. Seeling, Inc.,* 294 U.S. 511, 527 (1935).

The reciprocal or retaliatory insurance laws of the various states have a protective cast. Their burden on interstate commerce, however, is comparatively minimal, and the statutes do not build a wall around a state's economy which is impenetrable to interstate commerce. These points are illustrated by an examination of the effect of Tennessee's statute.

Tennessee's statute may serve as a basic example of a comparative retaliatory insurance law. First, it is reciprocal. Foreign insurors whose state of domicile does not exact taxes or other burdens in excess of Tennessee's comparable taxes and restrictions are benefited by the Tennessee statute; they may participate in Tennessee's marketplace without paying any assessment under Tenn. Code Ann. §56-4-218; these foreign insurors are thus classed with domestic insurors and experience no increased tax or like burden. Of the 962 foreign insurors doing business in Tennessee, 666 did not have to make any payment

pursuant to Tenn. Code Ann. §56-4-218.[1] Tennessee's statute becomes retaliatory in nature only when the foreign insuror's state of origin taxes, or otherwise restricts, Tennessee insurors doing business in that state in excess of taxes assessed by Tennessee on an insuror doing business in Tennessee. Of 962 foreign insurors doing business in Tennessee, 296 fall into the latter category. That the assessment thus imposed upon the latter group is not discriminatory in that it inhibits or prohibits foreign insurors from entering Tennesseee's marketplace is a simple matter of dollars and cents. Foreign insurors did $2,258,499,939 worth of business in Tennessee in 1978. In that same year they paid out $1,496,429[2] under the comparative retaliatory insurance law. Regulation by the comparative retaliatory insurance statute thus does not, on balance, impose a burden which is clearly excessive in relation to the benefits of doing business in Tennessee's marketplace. *See Pike* v. *Brick Church, Inc.*, 397 U.S. 137 (1970). An insuperable barrier to out-of-state insurors is not raised by Tennessee's statute. To the contrary, foreign insurors compete vigorously with domestic insurors in Tennessee. The retaliatory insurance statute, although it serves to protect the state's domestic insuror when the latter chooses to do business in another state, is not inimical to the Commerce Clause because it does not inhibit the flow of insurance business across state lines. The tax assessed is specifically related to a protective function, but, in the end, it generally equalizes burdens as between insurors of two different states and does not prohibit their growth and entrance into new marketplaces.

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[1]These statistics are available through the Department of Insurance, State of Tennessee, and are from the calendar year 1978. The number of foreign insurors doing business in Tennessee increased in 1979 to 987, of which 367 were assessed a retaliatory tax.

[2]The amount of retaliatory tax collected in 1979 was $2,246,347. In contrast, it should be noted that the total amount of premium taxes collected in 1978 was $55,243,192, and in 1979, $59,769,742.

## IV.

### Equal Protection

Tennessee's comparative retaliatory insurance law does not single out foreign insurors for different treatment solely on the basis of their state of origin. The classes created by the statute do have a rational basis; the classifications are reasonably related to the legitimate state concern of regulating the business of insurance in the public interest.

An analysis of the Equal Protection challenge must begin with a review of what classifications are created by the statute. "Statutes create classifications which do not deny equal protection, it is only 'invidious discrimination' which offends the Constitution." *Lehnhausen* v. *Lake Shore Auto Parts,* 410 U.S. 356 (1973); *Williamson* v. *Lee Optical Co.,* 348 U.S. 483, 489 (1955). "If the ...classification is neither capricious nor arbitrary, and rests upon some reasonable consideration of difference or policy, there is no denial of equal protection of the law." *Brown-Forman Co.* v. *Kentucky,* 217 U.S. 563, 573 (1910). A statutory discrimination will not be set aside if any stated facts reasonably may be conceived to justify it. *Allied Stores of Ohio, Inc.* v. *Bowers,* 358 U.S. 522, 528 (1959). Where a state regulates in the economic field, the classification its legislation creates must be wholly irrational to fail under the Equal Protection Clause. The decisions of this Court presume the constitutionality of statutory discriminations in the economic field and "require only that the classification challenged be rationally related to a legitimate state interest." *City of New Orleans* v. *Dukes,* 427 U.S. 297, 303 (1976). *See also Lehnhausen* v. *Lake Shore Auto Parts Co.,* 410 U.S. 356 (1973).

The classifications created by the Tennessee statute may be delineated as follows:

(1) (a) Domestic insurors

(b) foreign insurors whose state of origin imposes no greater burdens, tax or otherwise, on Tennessee insurors than Tennessee would impose on the foreign insurors, and

(2) foreign insurors whose state of origin imposes a greater burden, tax or otherwise, on Tennessee insurors than Tennessee imposes on foreign insurors.

On the latter class falls the retaliatory assessment. Foreign insurors are not assessed the retaliatory tax simply because they come from outside Tennessee. The second factor defining the class is equally crucial and is the factor which triggers the assessment. The regulatory thrust of the Tennessee statute thus operates to tax only a specific group of foreign insurors.

The state has a legitimate interest in regulating the insurance industry; as this Court and Congress have both recognized. *See Prudential* v. *Hobbs,* 328 U.S. 822 (1946); *Prudential* v. *Benjamin,* 328 U.S. 408 (1946); 15 U.S.C. §1011 ("Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest...."). The rationale underlying the retaliatory insurance statute is that as between two states the insurance companies of each state doing business outside their own state of origin should carry equal burdens and thus compete equally from the same base. The states achieve such an objective through regulation of activity in their local economies. *See City of New Orleans* v. *Dukes,* 427 U.S. 297 (1976). Although a state has no right to isolate itself economically, it can, in the public interest, design legislation to create a more competitive atmosphere by equalizing the burdens among other competitors. The statutory classifications thus are not arbitrary; they are drawn as narrowly as possible to achieve equal restrictions on Tennessee insurors doing business in other states and foreign insurors coming into Tennessee to do business.

V.

**Effect Of Ruling Of Unconstitutionality**

A declaration by this Court that state comparative retaliatory insurance statutes are unconstitutional would have a devastating effect. The states would no longer have a regulatory tool with which to insure that their domestic insurance companies could compete in foreign markets, and the states would lose an established source of revenue. A decision to overrule *Prudential* v. *Benjamin* and declare the statutes unconstitutional should be applied prospectively only.

The traditional rule has been that an overruling decision operates retroactively. *See Fleming* v. *Fleming,* 264 U.S. 29 (1924). This rule is not without significant exemptions, however, and has not always been followed. *See, e.g., United States ex rel. Angelet* v. *Fay,* 333 F. 2d 12 (2nd Cir. 1964), *affirmed* 381 U.S. 654 (1965). This Court does have the power to make a ruling apply prospectively only; there is no federal constitutional impediment to the prospective application of a constitutional ruling. *See Great Northern Railway Co.* v. *Sunburst Oil & Refining Co.,* 287 U.S. 358 (1932). Where this Court has found special circumstances which warrant the denial of retroactive application, it has made the ruling prospective. *See Linkletter* v. *Walker,* 381 U.S. 618 (1965).

One such special circumstance is a showing that there has been justifiable reliance on the decision to be overruled and that those who have relied may be substantially harmed by the retroactive application of the decision. *See Gelpcke* v. *DuBuque,* 1 Wall. 175, 17 L. Ed. 520 (1863); *Lyons* v. *Westinghouse Electric Corp.,* 235 F. Supp. 526 (S.D.N.Y. 1964); *Shumaker* v. *Cincinnati,* 68 Ohio St. 603, 68 N.E. 1 (1903). Also, where a retroactive ruling might greatly burden the administration of justice, prospective application has been ordered. *Linkletter* v. *Walker,* 381 U.S. 618 (1965).

These special circumstances do exist here and warrant a prospective application of a decision of unconstitutionality. *Prudential* v. *Benjamin,* 328 U.S. 408 (1946), was a reassurance to the states that they could regulate in the field of insurance and could exact the type of tax here disputed. Millions of dollars have been collected by state governments and disbursed for public uses in reliance on *Prudential's* acknowledgement that state systems of taxation and regulation in the insurance industry were valid. A retroactive application of a decision of unconstitutionality would gravely hamper state government, both financially and administratively. Such a ruling would cast serious doubt upon the validity of many earlier judgments, and the very real potential for relitigation of many cases would severely encumber the administration of justice. Should the Court decide that retaliatory tax statutes are unconstitutional, the Court must apply the ruling prospectively to avoid the significant and overwhelming difficulties a retrospective application would spawn.

## CONCLUSION

For all the foregoing reasons, the State of Tennessee submits that the judgment of the Court of Appeal in favor of the validity of the comparative retaliatory tax statute of California should be affirmed.

Respectfully submitted,

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# APPENDIX

## APPENDIX A

TENN. CODE ANN. § 56-4-218 reads as follows:

When by the laws of any other state or foreign country any premium or income or other taxes, or any fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions are imposed upon Tennessee insurance companies doing business in such other state or foreign country, or upon their agents therein, which are in excess of such taxes, fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions imposed upon such insurance companies of such other state or foreign country doing business in Tennessee, or that might seek to do business in Tennessee, or upon their agents herein, so long as such laws continue in force the same premium or income or other taxes, or fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions and restrictions of whatever kind shall be imposed upon such companies of such other state or foreign country doing business in Tennessee, or upon their agents herein. The commissioner of insurance shall compute the burden of premium taxes on the basis of the basic premium tax rate levied by the laws of such other state or foreign country for the kind of business transacted without reduction in the basic premium tax rate for investments that a like Tennessee company may qualify for or as a result of investments such company may have made in Tennessee securities. Any tax, license or other obligation imposed by any city, county or other political subdivision of a state or foreign country on such Tennessee insurance companies shall be deemed to be imposed by such state or foreign country within the meaning of this section, and the commissioner of insurance for the purpose of this section shall compute the burden of any such tax, license or other obligation on an aggregate statewide or foreign country-wide basis as an addition to the rate of tax and to the charges that are or would be payable by similar Tennessee insurance companies in such state or foreign country. The provisions of this section shall be

applied on a retaliatory basis without consideration of any reciprocity an insurance company domiciled in another state or foreign country may claim due to lower premium or income or other taxes, or lower fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions that are imposed upon such insurance companies of other states or foreign countries doing business in Tennessee. Each foreign insurance company doing business in Tennessee shall furnish, over the signature and oath of its responsible officers, the necessary information for the computation of such taxes upon such forms as may be prescribed by the commissioner of insurance. The commissioner of insurance may issue any and all necessary regulations to carry out the purposes of this section. The provisions of this section shall not apply to ad valorem taxes on real or personal property or to personal income taxes.

The time and period of payment of the retaliatory tax shall be the same in all cases as that of the gross premium tax provided for in § 56-4-205, and no interest charges or credits shall be made or allowed for use or loss of use of funds due to any conflict of the time or period of payment in this state and such time or period in a foreign state or country.

## APPENDIX B

The Preamble to Chapter 185, Tennessee Public Acts of 1957, reads as follows:

Whereas, Certain states impose higher taxes upon Tennessee insurance companies doing business in those states than Tennessee imposes upon insurance companies from those states doing business in Tennessee; and

Whereas, Thirty-eight states have enacted reciprocity laws in order to protect their insurance companies doing business in other states, and approximately half the states, recognizing the wisdom of encouraging domestic enterprise, now tax domestic insurance companies on a more favorable basis than that applied to foreign insurance companies; and

Whereas, By Chapter 3, Public Acts of 1945 (Section 56-408 of Tennessee Code Annotated), the General Assembly of Tennessee imposed a two percent (2%) gross premiums tax on all insurance companies, both domestic and foreign. Prior to 1945, domestic companies were exempt from such tax, but since that time domestic companies have been taxed on exactly the same basis as foreign companies; and

Whereas, It is fair and proper than an insurance company domesticated in another state and doing business in Tennessee should pay the same taxes in Tennessee that a Tennessee company would be required to pay in such other state; and

Whereas, By Chapter 49, Public Acts of 1953 (Section 56-423 of Tennessee Code Annotated), the General Assembly adopted a reciprocity law and granted tax relief for the protection of domestic insurance companies other than life and accident and health insurance companies; and

Whereas, By extending the provisions of Section 56-423 of Tennessee Code Annotated to life and accident and health insurance companies and thereby requiring such insurance companies domesticated in other states and doing business in Tennessee to pay the same taxes in Tennessee as Tennessee companies would be required to pay in such other states, tax relief can be extended to domestic life and accident and health insurance companies and yet a substantial overall increase can be produced in state revenues.

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No. 79-1423

# In the Supreme Court of the United States

OCTOBER TERM, 1979

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THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, APPELLANT

*v.*

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA

---

*ON APPEAL FROM THE COURT OF APPEAL, SECOND APPELLATE DISTRICT, STATE OF CALIFORNIA*

---

## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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*v.*

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA

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*ON APPEAL FROM THE COURT OF APPEAL SECOND APPELLATE DISTRICT, STATE OF CALIFORNIA*

---

## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

---

### QUESTIONS PRESENTED

1. Whether Section 685 of the California Insurance Code violates the Equal Protection Clause of the Fourteenth Amendment by subjecting appellant, an Ohio insurance company, to higher taxes than are imposed upon California insurance companies because Ohio, without distinction between foreign and domestic companies, imposes higher taxes upon insurance companies than California imposes upon domestic insurance companies.

2. Whether Section 12241 of the California Revenue and Tax Code violates appellant's Fourteenth Amendment right to equal protection of the laws by denying to appellant because it is an out-of-state insurance company, a substantial part of the credit against its premium taxes, in the amount of the real estate taxes on its principal office in California, that would otherwise be allowable to an in-state insurance company.

3. Whether the California tax statutes imposing heavier taxes on out-of-state insurance companies than upon domestic insurance companies unconstitutionally discriminate against interstate commerce.

4. Whether the McCarran-Ferguson Act, 15 U.S.C. 1011-1015, authorizes California's statutory discrimination against interstate commerce.

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This brief is submitted to supplement the brief filed in response to the Court's invitation of May 12, 1980.

## OPINIONS BELOW

The order of the trial court and its Memorandum of Intended Decision and Conclusions of Law (J.S. App. 1a-24a) are not officially reported. The opinion of the Court of Appeal (J.S. App. 27a-36a) prior to its modification (J.S. App. 35a-36a) is reported at 99 Cal. App. 3d 410, 159 Cal. Rptr. 539. The order of the Supreme Court of California denying hearing (J.S. App. 36a) is unreported.

## JURISDICTION

The judgment of the Court of Appeal in favor of the validity of provisions of the Constitution and statutes of the State of California, the validity of which were drawn in question on the ground of repugnance to the Constitution of the United States, was entered on November 2, 1979 (J.S. App. 27a). The Court of Appeal denied a petition for rehearing on November 28, 1979 (J.S. App. 35a-36a). The Supreme Court of California denied a petition for hearing on December 27, 1979 (J.S. App. 36a). The notice of appeal to this Court was filed on February 11, 1980 (J.S. App. 37a-38a), and the Jurisdictional Statement was filed on March 13, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(2). This Court noted probable jurisdiction on October 6, 1980.

## CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Article I, Section 8, Clause 3 of the United States Constitution (the Commerce Clause) provides: "The Congress shall have Power * * * To regulate com-

merce with foreign Nations, and among the several States, and with the Indian Tribes."

Amendment XIV, Section 1 of the United States Constitution provides: "* * * No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State * * * deny to any person within its jurisdition the equal protection of the laws."

The relevant provisions of the McCarran-Ferguson Act, 15 U.S.C. 1011-1013, are as follows:

> § 1011. *Declaration of Policy*—Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.
>
> § 1012. *Regulation by State Law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948* —(a) The business of insurance and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C. 41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

§ 1013. *Suspension until June 30, 1948, of application of certain Federal laws; Sherman Act applicable to agreements to, or acts of, boycott, coercion, or intimidation*—(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act [15 U.S.C. 41 et seq.], and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

The relevant provisions of the Constitution and statutes of the State of California are set forth in J.S. App. 41a-46a.

## STATEMENT

1. Appellant brought this action in the Superior Court of the State of California for the County of Los Angeles to recover California taxes that it had paid under protest for the period 1965-1971.

The facts were stipulated (J.S. App. 3a-4a) and may be summarized as follows: Appellant is an Ohio mutual life and disability insurance company, and has its principal office in that State. It qualified to do business in California in 1956. Pursuant to Section 701 of the Cal. Ins. Code (West 1972), appellant was issued a Certificate of Authority for an indefinite term [1] on July 1, 1956. Appellant has conducted a

[1] Section 701 of the Cal. Ins. Code (West 1972) provides that a certificate of authority "shall be for an indefinite term and shall expire with the expiration or termination of a corporate existence of the holder thereof."

life and disability insurance business in California continuously since the issuance of its Certificate of Authority. Prior to 1965, appellant constructed an office building on land it owned in Los Angeles, and established its principal California office in that building. It has continued to maintain its principal California office in that building, but leases approximately 76% of the space in the building to tenants not related to its operations (J.A. App. 4a, 29a).

a. Pursuant to Sections 12201, 12202, and 12221 of the Cal. Rev. & Tax. Code (West 1970), California imposes upon every insurer doing business in the State, with exceptions not here relevant, an annual tax at a rate slightly in excess of 2.3% of gross premiums, less return premiums, received by the insurer upon business done in the State. Section 12204 of the Cal. Rev. & Tax. Code (West 1970) provides that this gross premiums tax is, with stated exceptions, "in lieu of all other taxes and licenses, state, county, and municipal, upon such insurers and their property." Among the stated exceptions are taxes upon insurance companies' real estate and the so-called retaliatory tax authorized by Article XIII, Section 14-4/5(f)(3) of the California Constitution and imposed by Section 685 of the Cal. Ins. Code (West 1972) (J.S. App. 41a-43a). This latter provision applies to the case of an insurer doing business in California, but incorporated in another state, where the state of incorporation would (even though without differentiation between domestic and out-of-state insurers) impose upon California insurers doing business in that state a greater aggregate of taxes and fees, than California would impose upon insurers of the other state doing business in California. In these circumstances, the California retaliatory tax requires that insurers

incorporated in the other state pay (in addition to the tax otherwise imposed) an additional amount to bring the aggregate of taxes and fees payable to California up to the total amount that would have been payable to the other state.[2]

Acting under Section 685 of the Cal. Ins. Code, the State Board of Equalization issued against appellant a retaliatory tax assessment of $128,214.90 for 1965, and lesser amounts for the succeeding years through 1971, all of which appellant paid under protest.[3] It was stipulated that Ohio does not impose upon California insurers doing business in Ohio greater taxes, fees, etc. than upon domestic insurers doing business

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[2] Prior to 1965, this so-called retaliatory tax was imposed upon out-of-state insurers doing business in California only if their state discriminated against California insurers doing business in that other state. In 1964, however, the California Constitution was amended, and, since 1965, California has imposed the so-called retaliatory tax upon out-of-state insurers doing business in California simply because the level of taxation in their home state, undifferentiated though it might be between domestic and out-of-state insurers, was higher than the level of taxation upon insurers in California. See *Western & Southern Life Ins. Co.* v. *State Board of Equalization*, 4 Cal. App. 3d 21, 84 Cal. Rptr. 88 (1970); *Atlantic Ins. Co.* v. *State Board of Equalization*, 255 Cal. App. 2d 1, 62 Cal. Rptr. 784 (1967); *Franklin Life Ins. Co.* v. *State Board of Equalization*, 63 Cal.2d 222, 404 P. 2d 477, 45 Cal. Rptr. 869 (1965).

[3] The retaliatory tax is computed as an amount in excess of the premiums tax. The amount of the premiums tax is also in contest for 1966-1971 (see *infra*, page 6). Hence, the amounts of the two taxes for the years after 1965 are not separately designated. The aggregate amount in issue is $977,853.57, plus interest. (J.S. App. 24a, 26a.)

in Ohio, and the trial court so found (J.S. 6, n. 2; J.S. App. 10a, 21a).[4]

b. Section 12241(a) of the Cal. Rev. & Tax. Code (West 1970) allowed to an insurer a credit against the annual premiums tax equal to the real estate taxes paid for the same year on real property owned by it on which was located its home office or principal office in the state.[5] In accordance, however, with an amendment to Article XIII, Section 14-4/5(e) of the California Constitution adopted in 1966, Section 12241(b) provided thereafter that where a portion of the real property constituting the home or principal office was occupied by any person or persons other than the insurer, the credit allowed by Section 12241(a) was proportionately reduced. This reduction in the credit, however, was not applicable to insurers organized under the laws of California before December 31, 1966. As a result of those statutory provisions, appellant's credit against its premiums taxes was reduced by approximately 76% for the years in issue, while similarly-situated California insurers suffered no reduction at all in their credit.

2. Appellant paid both the retaliatory tax assessments for 1965-1971 and the additional premiums taxes for 1966-1971 under protest, the latter because of the reduced "principal office" credit (J.S. App. 3a-4a). It thereafter filed claims for refund of retaliatory taxes and the amount of the premiums taxes paid under protest, and, when those claims were denied, brought this action for refund of the taxes in

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[4] See also *Western & Southern Life Ins. Co.* v. *State Board of Equalization*, 4 Cal. App. 3d 21, 84 Cal. Rptr. 88 (1970).

[5] The provision allowing this credit was repealed in 1976, effective January 1, 1977 (J.S. App. 16a).

issue in the Superior Court for the County of Los Angeles.

The Superior Court entered judgment in favor of appellant for the full amount of the refunds sought, plus statutory interest (J.S. App. 24a, 26a). It held that in discriminating against corporations engaged in interstate commerce and in favor of domestic corporations, both the retaliatory tax and the limits on the "principal office" credit violated the Commerce Clause and appellant's rights to due process and equal protection as guaranteed by the Fourteenth Amendment. The court also held that the California retaliatory tax was not authorized by the McCarran-Ferguson Act, 15 U.S.C. 1011-1015 (J.S. App. 3a-24a).

The Court of Appeal reversed (J.S. App. 27a-34a). It held that the retaliatory tax was authorized by the McCarran-Ferguson Act (J.S. App. 30a-31a). On the authority of its earlier decision in *Atlantic Ins. Co.* v. *State Board of Equalization*, 255 Cal. App. 2d 1, 62 Cal. Rptr. 784 (1967), the court held that the retaliatory tax did not violate either the Commerce Clause or appellant's right to equal protection of the laws under the Fourteenth Amendment (J.S. App. 32a-33a). The court stated with respect to its *Atlantic Ins. Co.* decision, "Right or wrong, we feel impelled to follow it in the case before us" (J.S. App. 33a). Finally, the Court of Appeal ruled that it did not have to address the limits on the "principal office" credit allowed out-of-state insurers because to the extent that appellant's premiums tax was reduced, its retaliatory tax would be increased (J.S. App. 33a-34a). The Court of Appeal denied a petition for rehearing (J.S. App. 35a-36a), and the Supreme Court of California denied appellant's petition for hearing (J.S. App. 36a).

## SUMMARY OF ARGUMENT

1. The California retaliatory tax upon out-of-state insurance companies such as appellant violates the Equal Protection Clause of the Fourteenth Amendment and is inconsistent with the limitations imposed upon the states by the Commerce Clause. Here, appellant is subject to the California retaliatory tax solely because Ohio, its state of incorporation, imposes upon insurers, though in completely evenhanded fashion, a somewhat higher level of tax than does California. As this Court has pointed out, the Constitution does not contemplate the economic warfare of reprisal and retaliation among the states. *A&P Tea Co.* v. *Cottrell*, 424 U.S. 366 (1976). Thus, the decisions of this Court have consistently struck down such discriminatory taxes as violative of the Equal Protection Clause of the Fourteenth Amendment. *E.g.*, *WHYY* v. *Glassboro*, 393 U.S. 117 (1968). The considerations that underlay those decisions require reversal of the judgment below.

2. Contrary to the reasoning of the Court of Appeal, the McCarran-Ferguson Act does not save the constitutionality of this tax. All that Act accomplished was to permit the states to regulate the business of insurance. The legislative history clearly states that Congress did not intend to grant to the states any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to this Court's decision in *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944). Accordingly, the McCarran-Ferguson Act should not be construed to sanction the barrier of economic protectionism California seeks to erect here.

*Prudential Ins. Co.* v. *Benjamin*, 328 U.S. 408 (1946), is not to the contrary. In upholding a South

Carolina premiums tax, the Court's emphasis in that case was to affirm Congress' power to authorize the states to regulate insurance. The particular details of the McCarran-Ferguson Act were not considered by the Court. Moreover, the Court "express[ed] no opinion concerning the validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein" (328 U.S. at 431-432 n.40). Hence, the decision in that case does not speak to the constitutionality of the retaliatory taxes at issue in this case.

## ARGUMENT

The California tax statutes at issue in this case violate the Equal Protection Clause of the Fourteenth Amendment, and are inconsistent with the limitations imposed upon the States by the Commerce Clause. As this Court has held in *State Bd. of Ins.* v. *Todd Shipyards*, 370 U.S. 451 (1962), the McCarran-Ferguson Act, 15 U.S.C. 1011-1015, does not relax the limitations that the Fourteenth Amendment imposes upon the States. And that Act should not be construed to authorize state action hostile to, and discriminatory against, out-of-state insurers engaged in interstate commerce in the manner of the California statutes.

1. Appellant qualified to do business in California in 1956. Since that time, it has held an indefinite license, coterminous under California law with its corporate existence, to do business as a life and disability insurer. Accordingly, the annually recurrent taxes here in question have none of the character of an entrance fee imposed upon a foreign corporation as a condition of admission to conduct business in the state, of the type that the Court has upheld. See *WHYY* v. *Glassboro*, 393 U.S. 117, 119 (1968). On

the contrary, the so-called retaliatory tax imposed by Section 685 of the Insurance Code, and the limitation on the "principal office" credit against the premiums tax imposed by Section 12241(b) of the Revenue and Taxation Code, are recurrent burdens imposed upon appellant because it is a foreign corporation—domestic insurers are subject to neither. Indeed, appellant is subject to the retaliatory tax solely because Ohio, its state of incorporation, imposes upon insurers, though in completely evenhanded fashion, a somewhat higher level of taxation than does California.

We submit that California has no legitimate interest in Ohio's level of taxation or fiscal structure when no discriminatory action against California citizens or corporations is involved. Cf. *Toomer* v. *Witsell*, 334 U.S. 385, 395-407 (1948). The several states have different resources, populations, social and economic conditions, levels of public services, fiscal structures, methods and sources of raising revenue, and tax burdens, both in gross and per capita. With respect to other states, where no discriminatory or hostile action is involved, the states are largely autonomous in these matters. And even if another state has engaged in discriminatory action, the Constitution, as this Court has pointed out, does not contemplate the economic warfare of reprisal and retaliation. *A&P Tea Co.* v. *Cottrell*, 424 U.S. 366 (1976).

Since Ohio does not in fact discriminate against California or other out-of-state insurers, there is no greater justification for the tax imposed by Section 685 of the Insurance Code than there would be if California imposed upon Ohio residents who happened to own land in California a higher property tax than was otherwise imposed simply because the level of real property taxation was higher in Ohio

than in California. Section 685 and the limitation upon the "principal office" credit mandated by Section 12241(b) of the Revenue & Taxation Code [6] constitute tax burdens imposed upon foreign corporations because they are foreign corporations. The decisions of this Court have consistently struck down such discriminatory taxation as violative of the Equal Protection Clause of the Fourteenth Amendment. *E.g.*, *WHYY* v. *Glassboro*, 393 U.S. 117 (1968); *Reserve Life Ins. Co.* v. *Bowers*, 380 U.S. 258 (1965); *Wheeling Steel Corp.* v. *Glander*, 337 U.S. 562 (1949); *Hanover Fire Ins. Co.* v. *Harding*, 272 U.S. 494 (1926); *Southern Ry.* v. *Greene*, 216 U.S. 400 (1910). The considerations that underlay those decisions require reversal of the judgment below.

2. Throughout the history of this Court's decisions involving state taxation of interstate commerce, there have been "some firm peaks of decision which remain unquestioned." *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 458 (1959). "Among these is the fundamental principle that * * *: No State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business.' " *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 329 (1977). There, the Court held that the State of New York could not impose a tax "to favor local commercial interests over out-of-state businesses," even though the discrimination was "between two types of inter-

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[6] If, as we believe, Section 685 of the Insurance Code is unconstitutional, it is no longer possible to avoid, as did the Court of Appeal, passing upon the constitutionality of the discriminatory aspects of the "principal office" credit limitation imposed by Section 12241(b) of the Revenue and Taxation Code.

state transactions" (429 U.S. at 335). Only last Term, the Court applied the same criteria in striking down, under the Commerce Clause, a Florida statute that prohibited an out-of-state bank holding company from owning or controlling a business furnishing investment advisory services to the general public. *Lewis* v. *BT Investment Managers, Inc.*, No. 79-45 (June 9, 1980). As the Court there observed, "where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected," quoting from *Philadelphia* v. *New Jersey*, 437 U.S. 617, 624 (1978).

Judged by these standards, the California statutes here in question would appear, if standing alone, to be inconsistent with the Commerce Clause, and the could below did not assert otherwise. The only remaining question is whether the McCarran-Ferguson Act should be construed to permit the "simple economic protectionism" exemplified by the California statutes involved in the case.

We think not, and submit that the history and purpose of the McCarran-Ferguson Act demonstrate that it should not. But we start with a more fundamental premise. As the Court pointed out in *Boston Stock Exchange*, quoting from earlier decisions, "'[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States'" (429 U.S. at 328). See also *Freeman* v. *Hewit*, 329 U.S. 249, 253 (1946). An Act of Congress should therefore not be construed to frustrate that purpose unless by its explicit terms the legislation authorizes the practice of economic protectionism by the States.[7] Indeed, on several occasions, this Court

[7] "The other relevant canon of construction that comes into play is that when a statute is ambiguous, 'construction should

Sherman Antitrust Act, 15 U.S.C. 1 and 2. Many people professed to believe that the decision effectively immunized multi-state insurers, and a large part of the business of insurance, from state regulation and from state taxation. That such a belief was greatly overdrawn was demonstrated not only by the Court's subsequent decision in *Robertson* v. *California*, 328 U.S. 440 (1946), but also by the contemporaneous treatment of interstate carriers and of manufacturers, wholesalers, and others engaged in interstate commerce on a large scale. Congress, nevertheless, felt impelled to act. The reason for action and the intended scope of action are well described in the Report of the House Committee on the Judiciary, H.R. Rep. No. 143, 79th Cong., 1st Sess. 2-3 (1945), as follows:

> Inevitable uncertainties which followed the handing down of the decision in the *Southeastern Underwriters Association case*, with respect to the constitutionality of State laws, have raised questions in the minds of insurance executives, State insurance officials, and others to the validity of State tax laws as well as State regulatory provisions; thus making desirable legislation by the Congress to stabilize the general situation.
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> * * * Your committee believes there is urgent need for an immediate expression of policy by the Congress with respect to the continued regulation of the business of insurance by the respective States. Already many insurance companies have refused, while others have threatened refusal to comply with State tax laws, as well as with other State regulations, on the ground that to do so, when such laws may subsequently be held unconstitutional in keeping with the precedent-smashing decision in the *Southeastern Underwriters*

has declined to construe federal statutes to permit state action that would have excluded or discriminated against out-of-state competition, even where the federal statute authorized state regulation. *Lewis* v. *BT Investment Managers, Inc.*, No. 79-45 (June 9, 1980), slip op. 16-21; *Hood & Sons* v. *Du Mond*, 336 U.S. 525, 540-545 (1949); *Scott* v. *Donald*, 165 U.S. 58, 100 (1897). And where the Court upheld earlier federal legislation that reinforced or authorized state restrictions on the sale of interstate goods, the Court was careful to point out that the restrictions were nondiscriminatory. *Ky. Whip & Collar Co.* v. *Illinois Central R.R.*, 229 U.S. 334, 351 (1937); *Whitfield* v. *Ohio*, 297 U.S. 431, 439-440 (1936).

3. The McCarran-Ferguson Act was passed in response to this Court's decision in *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).[8] In that case, the Court held that multi-state insurers were engaged in commerce among the several States, and were subject to the provisions of the

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go in the direction of constitutional policy.'" *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 134 (1974). See also, *e.g.*, *Watts* v. *United States*, 394 U.S. 705, 708 (1969); *Kent* v. *Dulles*, 357 U.S. 116, 129 (1958); *Hannegan* v. *Esquire, Inc.*, 327 U.S. 146, 155-156 (1946).

[8] This Court has examined the legislative history of the McCarron-Ferguson Act in a substantial number of cases. It has never suggested, however, that the terms of the Act could be construed to authorize the discriminatory type of tax upheld by the court below. See also pages 16-17 & note 11, *infra*. *See, e.g., Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979); *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531 (1978); *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969); *State Bd. of Ins.* v. *Todd Shipyards*, 370 U.S. 451 (1962); *FTC* v. *Travelers Health Ass'n*, 362 U.S. 293 (1960); *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959); *FTC* v. *National Casualty Co.*, 357 U.S. 560 (1958); *Maryland Casualty Co.* v. *Cushing*, 347 U.S. 409 (1954); *Prudential Ins. Co.* v. *Benjamin*, 328 U.S. 408 (1946).

*case*, will subject insurance executives to both civil and criminal actions for misappropriation of company funds.

* * * * *

*It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the Southeastern Underwriters Association case* [emphasis supplied].

The pertinent Senate report, S. Rep. No. 20, 79th Cong., 1st Sess. (1945), is basically to the same effect. In presenting the Conference Report to the Senate, Senator McCarran read from the Report of the House Judiciary Committee, and added, "[i]n other words, we give to the States no more powers than those they previously had, and we take none from them." 91 Cong. Rec. 1442 (1945).

The congressional debate (91 Cong. Rec. 478-488, 1085-1094, 1396, 1442-1444, 1477-1489 (1945)) principally concerned antitrust legislation—whether it should be displaced by state legislation, suspended, partially suspended, restored after a period of suspension, etc.[9] The uncertainties of state taxation of insurance companies are mentioned from time to time, but rarely more than briefly.[10] Typical was Representative Springer's remark that the pending

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[9] Sections 2 and 3 of the Act, 15 U.S.C. 1012 and 1013, embody the compromises that were reached after extended discussions.

[10] For example, Representative Walter reported to the House that the Attorney General of North Carolina had ruled that the State could no longer collect taxes paid by insurance companies. See 91 Cong. Rec. 1085 (1945).

measure would allow the states "to collect the taxes now permitted—all without Government interference." 91 Cong. Rec. 1092 (1945). See also, *e.g.*, 91 Cong. Rec. 482 (1945) (Senator Radcliffe, "the right of the States * * * to collect taxes should not be terminated"). There is nothing explicit in the debate, the committee reports, or the terms of the statute that suggests that the states were given authority to erect barriers of economic protectionism. Insofar as state taxes were concerned, Congress was aware that current state revenues were in jeopardy of interruption, and intended to remove that hazard and uncertainty. Nothing suggests that Congress ever considered, or that the states were in fact given, enhanced authority to exclude, or to interfere with, competition by out-of-state insurers. Cf. *Maryland Casualty Co.* v. *Cushing*, 347 U.S. 409, 412-413 (1954).

Moreover, this Court's decisions under the McCarran-Ferguson Act have not in other respects construed the Act to sanction anticompetitive arrangements.[11] There is no reason why the McCarran-Ferguson Act should be construed to permit what had never been countenanced prior to the *South-Eastern Underwriters* decision, *viz.*, anti-competitive state taxation that discriminates against out-of-state insurers. In passing the McCarran-Ferguson Act, Congress intended to do nothing more than to "turn back the clock, to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 459

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[11] See, *e.g.*, *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979); *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531 (1978).

(1969). See also *id.* at 458-460. In short, the McCarran-Ferguson Act does not sanction the California retaliatory taxes at issue here.

4. *Prudential Ins. Co.* v. *Benjamin*, 328 U.S. 408 (1946), principally relied upon by the court below (J.S. App. 31a-32a), is not to the contrary. There, the Court upheld a South Carolina statute on out-of-state insurance companies that imposed a tax of 3% of premiums from business done within the state as a condition of doing business within the state, without differentiating between interstate and local transactions. The tax was not imposed on South Carolina companies but the State Supreme Court had held that the tax was not discriminatory in view of other taxes imposed upon domestic corporations. *Prudential Ins. Co.* v. *Murphy*, 207 S.C. 324, 331, 355 S.E. 2d 586, 588 (1945). Without making an independent review of that determination, this Court concluded that in light of the McCarran-Ferguson Act, the South Carolina tax did not violate the Commerce Clause.

But in so holding, the Court's emphasis was to establish the power of Congress, challenged by the appellant in that case, to authorize the states to take action that, in the absence of congressional authority, might be deemed to be inconsistent with the Commerce Clause. What Congress had in fact authorized received lesser consideration. In that the Court was explicit: "It is not necessary to spend much time with interpreting the McCarran Act" (328 U.S. at 429). It was not established that the South Carolina tax in issue was in fact discriminatory, and the Court refrained from addressing that question (*id.* at 428).

Moreover, the Court did not rule upon the validity of any other state tax upon insurance companies. To the contrary, it "express[ed] no opinion concerning the

validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein." Hence, the Court's decision with respect to a state premiums tax is not authoritative with respect to the constitutionality of the retaliatory taxes at issue here (*id.* at 431-432 n.40). Given this explicit disclaimer by the Court, there is no reason to believe that *Prudential Ins. Co.* v. *Hobbs*, 328 U.S. 822 (1946) and *Prudential Ins. Co.* v. *Indiana*, 328 U.S. 823 (1946), both decided summarily per curiam a week later on the authority of *Benjamin*, stand for more than the principal decision.

In sum, unlike *Prudential Ins. Co.* v. *Benjamin*, *supra*, the question in this case does not concern the scope of Congress' power to ratify state taxation of insurance companies doing business in interstate commerce. That question has long been resolved. This case involves the proper construction of the McCarran-Ferguson Act and its impact upon: (1) a retaliatory California tax that is imposed upon appellant simply because it is an out-of-state insurance company whose state of incorporation maintains a somewhat higher tax rate than California; and (2) a limitation upon the credit against its premiums tax that is imposed because it is an out-of-state corporation. We believe that the Act should not be construed to authorize California's discriminatory examples of statutory protectionism.

## CONCLUSION

The judgment of the Court of Appeal should be reversed.

Respectfully submitted.

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